HOUSING SUBSIDIES AND HOUSING POLICIES

HEARINGS

BEFORE THE

SUBCOMMITTEE ON PRIORITIES AND ECONOMY IN GOVERNMENT

OF THE

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Monday, December 4, 1972

HOUSING SUBSIDIES AND HOUSING POLICIES

MONDAY, DECEMBER 4, 1972

Congress of the United States,
Subcommittee on Priorities and
Economy in Government of the
Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., in room G–308, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire; and Representatives Conable and Blackburn.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

Opening Statement of Chairman Proxmire

Chairman Proxmire. The subcommittee will come to order.

This hearing this morning begins a series of hearings on our housing programs and I am very much concerned about them for many reasons. One of them is I have a personal concern as the Democrat ranking next to Senator Sparkman on both the Banking, Housing and Urban Affairs Committee and on the Subcommittee on Housing, and also as the new chairman of the Appropriations Subcommittee that handled the funds in the Appropriations Committee for Housing and Urban Development. I am very concerned about this program.

Our Federal housing programs are in trouble, serious trouble. The last Congress failed to enact the expected continuation of the housing program. The new Congress will next month face decisions in housing and will probably change, and dramatically change, the Federal Government's approach to housing.

The administration is considering drastic cuts in Federal housing subsidies on the ground they do not work. These circumstances and the lack of good information on the effectiveness of housing programs made these hearings on housing necessary. The general purpose of the hearings will be to find out what is wrong with the Federal housing programs and to develop alternative approaches. There have been high rates of FHA-insured mortgage foreclosures, widespread cases of fraud and corruption among appraisers, real estate agents, mortgage brokers, and Federal Department of Housing and Urban Development (HUD) employees. Only last week four HUD employees and

one real estate speculator were indicted in Detroit for exchanging bribes to inflate house appraisals.

It is not the primary purpose of these hearings to investigate alleged scandals or to review the management of housing programs. If we are to determine which programs have economic viability for the future, however, we must isolate any mismanagement that may have led to the difficulties that have surfaced in the past 2 years. To what extent are the failures in housing inherent in the major housing subsidy programs, such as the 235 homeownership program, and to what extent are they the product of nonsubsidized housing programs? Why have some Federal housing programs outside of HUD not experienced the same kinds of failure and corruption? We will examine the management of the Federal housing programs to find out why the Federal Government is not doing its job and is failing to reduce housing costs so more Americans can afford decent homes. The Federal Government has not led but it should lead an attack across the board on lumber costs, land appraisal costs, closing costs, interest costs, construction costs, reducing restrictions on site improvements and codes, reducing construction time in Federal programs, improved work practices, and so on.

Now, this just is not being done. There is a need to look at housing program alternatives that have been proposed for consideration. Does turning the present program over to State and local governments for administration get at the gut relationships of costs and benefits which accrue to the various participants in housing production and consumption.

We will also want to carefully examine under what circumstances the housing allowance proposal could be successful.

Today we hope to obtain an insight into deficiencies in some of our subsidized housing programs. The General Accounting Office has been analyzing the management and operation of several Federal housing programs. They have just completed what amounts to a nationwide evaluation of the effectiveness of the 235 homeownership subsidy program managed by HUD, the 502 homeownership subsidy program managed by the Department of Agriculture, and the 236 rental subsidy program managed by HUD.

Elmer Staats, the Comptroller General of the United States, is here to testify on what the General Accounting Office has found and their recommendations for reform.

We are also fortunate in being able to start the hearings with a panel of three distinguished and knowledgeable witnesses: Lawrence Katz was former Director of the FHA insuring office in Milwaukee for many years and successfully managed subsidized housing programs in his jurisdiction, while failures under the same program were developing in other areas. I know Larry Katz. I have the greatest admiration and respect for him, and he has shown that although these programs may be deficient in conception, they can be managed efficiently and with considerable success, given a man of Mr. Katz' extraordinary ability.

Philip Brownstein, former HUD Assistant Secretary in charge of FHA and an individual very expert in housing management. We are delighted to have Mr. Brownstein here, who has impressed this com-

mittee many times; and Walter Smart, executive director of the National Federation of Settlements and Neighborhood Centers, and an individual experienced in the problems of the low- and moderate-income families who are the consumers of subsidized housing.

We will have that panel on right after our distinguished Comptroller General.

Mr. Staats, go right ahead.

STATEMENT OF HON. ELMER B. STAATS, COMPTROLLER GENERAL, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY HENRY ESCHWEGE, DIRECTOR, RESOURCES AND ECONOMIC DEVELOPMENT DIVISION (REDD); GENE BIRKLE, ASSOCIATE DIRECTOR (REDD); CLARE E. ROHER, SUPERVISORY AUDITOR (REDD); AND KELTON M. SEELIG, SUPERVISORY AUDITOR, LOS ANGELES OFFICE

Mr. Staats. Thank you, Mr. Chairman. I have condensed our testimony at your request.

Chairman Proxmire. Oh, yes, let me say that your entire prepared statement and the appendixes, which are very helpful, too, will be printed in full in the record at the end of your oral statement, and you can proceed in any way you wish. I understand you do have a shorter version.

Mr. Staats. Right. Thank you very much.

Chairman Proxmire. May I just interrupt to ask, Mr. Staats, would you identify the distinguished men at the table with you?

Mr. Staats. To my immediate right is Mr. Henry Eschwege, who is Director of our Resources and Economic Development Division, which encompasses housing, among other activities; on my immediate left, Mr. Gene Birkle, who is Associate Director of that Division, who has had immediate responsibility for the work we have done in the housing area and particularly the two reports that we will be reporting on here today; and to his left, Mr. Clare Rohrer, who is a supervisory auditor in the same Division; and to his left Mr. Kelton Seelig, who is a supervisory auditor in our Los Angeles office. They will all be prepared to answer questions at the conclusion of my oral statement, if you desire.

As I have indicated, during the past 3 years, we have issued over 100 reports in the housing area, including reports on Model Cities, low-rent housing, urban renewal, and mortgage insurance activities. This morning, I will discuss the results of two reviews we recently made of the manner in which the Departments of Housing and Urban Development (HUD) and Agriculture have carried out housing subsidy programs. The complete results of both reviews will be published in reports to be issued within the next few weeks, hopefully within the month.

As requested by the subcommittee, I will provide a brief summary of our work at this time. A more detailed statement of our findings and recommendations has been supplied for the record in the prepared statement.

First. I will discuss the homeownership assistance programs.

We found that HUD and Agriculture did not allocate program resources to insure that eligible families had the same opportunity to participate in the homeownership assistance programs regardless of where they lived.

The need for subsidized housing had not been adequately identified by either HUD or Agriculture. HUD headquarters estimated the need for subsidized housing; however, this estimate varied significantly from the need estimated by HUD field offices and the differences were not reconciled to arrive at reasonably reliable data. Neither Agriculture headquarters nor its field offices had developed estimates of rural subsidized housing needs as a basis for allocating program resources.

An area's capacity to produce housing was a major factor influencing the distribution of HUD program resources at both the national and local levels. Allocation of Agriculture program resources at the national level was based primarily on prior years' production activity and distribution at the local level was primarily on a first-come, first-served basis.

We are recommending that HUD and Agriculture provide reasonable assurance that resources under sections 235 and 502 programs are allocated primarily in proportion to identified needs. We are recommending also that Agriculture make separate allocations for subsidized and unsubsidized housing loans in accordance with need.

Next, we would like to point out that houses with significant defects were sold under these two homeownership assistance programs. Because many of the housing defects concern the safety and health of the occupants, the objective of providing low- and moderate-income families with decent, safe, and sanitary housing was not met in many cases.

A physical inspection, performed by HUD auditors and monitored by GAO, of 1,281 section 235 properties selected on the basis of a statistical random sample showed that about 24 percent of the new houses and about 39 percent of the existing houses had defects.

HUD inspection procedures, which are supposed to prevent defective houses from being insured, were inadequate because (1) appraisers had not been adequately trained to make inspections, (2) the emphasis on providing houses had placed an unusually heavy workload on field office appraisers, (3) appraisers were not adequately supervised, and (4) field office personnel did not adjust their thinking and attitudes to encompass the consumer-oriented needs of the new program.

We inspected 121 houses in eight States under the Agriculture administered sections 235 and 502 programs and found that over 50 percent had defects similar to those found in the HUD section 235 program. Agriculture officials advised us that houses with defects have been provided because the houses were inspected by county supervisors who were not qualified as housing inspectors.

HUD and Agriculture have taken or planned corrective actions to improve their inspection procedures. However, to provide adequate protection to purchasers, we are recommending that HUD and Agriculture reinspect all houses within 1 year after purchase to insure that defects covered by builder service policies and seller certifications have been identified and corrected.

Mr. Chairman, we have taken a number of photographs which will appear in our report when it is finally submitted to the Congress. We have three or four sets of these. I think they tell the story much better than anything I can put in text as to the conditions of some of these houses. Some of these houses, of course, are sold to very low-income people who are not sophisticated, and who have no ability to detect some of these defects at the time they acquire the housing. But this is something which we think is quite important and if you would like we would have Mr. Birkle give you a couple or three sets of these so you can look at them at this point in our testimony.

Chairman PROXMIRE. Fine, thank you. We will be happy to receive them.

Mr. STAATS. You can see just by leafing through, these are photographs taken by our auditors in the conduct of this review.

We are also recommending that the Secretary of Agriculture implement procedures or seek legislation, if considered necessary, to insure that Agriculture and/or the purchaser of existing housing has recourse to the seller to cover the cost of repairing defects that existed at the time of sale.

We also noted that HUD and Agriculture did not provide their field offices with adequate guidelines defining the type of housing eligible under homeownership assistance programs for low- and moderate-income families. As a result, some families could buy homes with options such as air conditioning, fireplaces, or extra bedrooms, while other families in the same general area were unable to obtain these options.

We are recommending that HUD and Agriculture (1) clearly define the type of housing options that will be made available under homeownership assistance programs in the various areas of the Nation, and (2) jointly determine what housing options are appropriate for inclusion in houses being provided in communities served by both Departments.

Our next observation concerns the mortgage default rates on the section 235 and section 502 programs.

Preliminary information indicates that mortgage defaults could become a major problem for the section 235 program. The number of defaults in the section 502 program has been low to date; however, Agriculture officials anticipate that increased program activity will result in a marked increase in the default rate.

Although a precise default rate for the section 235 program has not been developed, the pattern of defaults thus far closely parallels HUD's experience on another mortgage insurance program for low- and moderate-income families which shows a default rate of about 11 percent after 9 years.

The average loss to manage and dispose of a section 235 property is about $3,800. If the default rate reaches 10 percent on the 1.4 million properties to be insured through fiscal year 1978, HUD would eventually incur losses of about $532 million to manage and dispose of acquired section 235 properties.

We are recommending that HUD and Agriculture require in depth studies to determine the major reasons for defaults and use the results

to develop guidelines for screening and counselnig program applicants.

Our last observation concerns the method of financing HUD's homeownership assistance program. We estimate that the present value of the savings on the section 235 program could amount to about $1 billion if loans were financed directly by the Government rather than by private lenders because of the lower interest cost at which the Government could borrow funds.

In a previous report to the Congress in July of last year, we recommended that the Congress consider amending the legislation pertaining to the section 502 program to require direct Federal financing, and we are now recommending that the Congress consider similar legislation for the section 235 program.

I now turn to the rental assistance program. Providing adequate rental housing for low- and moderate-income families is one of the major issues facing the Nation today. To increase the number of rental housing units available to these families, a mortgage insurance program was authorized by section 236 of the National Housing Act. Under the program, HUD provides financial assistance by paying the mortgage insurance premiums and a portion of the interest costs. HUD interest subsidy payments make possible lower rents to the tenants.

I previously discussed the need for improving procedures in the allocation of section 235 program resources and our recommendation that HUD provide a reasonable assurance that program resources are allocated primarily in proportion to identified needs.

Because the same general deficiencies were observed in the allocation of section 236 program resources, we are recommending that HUD provide a better identification of housing needs and assure that section 236 resources are allocated primarily in proportion to identified needs.

Because HUD did not give adequate consideration to purchase price or option price data, its appraisals of land to establish section 236 mortgage loan amounts may have unduly increased mortgage loans, resulting in higher interest subsidy costs to the Government, and probably higher rents to project tenants.

We examined the land valuation assigned to 68 recently completed section 236 projects administered by HUD field offices in Atlanta, Dallas, and Los Angeles. Project land was valued by HUD above its cost to the owner for 47 of the 68 projects. For 12 of the 47 projects, HUD valued the land at 125 percent or more of the owner's cost, and the valuations had been made within 24 months of the owner's acquisition of the land. Five of the HUD valuations involved land which the project sponsors did not yet own—they only had purchase options.

We estimate that the difference between HUD's valuation and the cost of land for the 12 projects could increase HUD's interest reduction payments by about $2 million over the life of the 12 mortgage loans. We have attached to our prepared statement a table showing the variations between the owner's cost and HUD's valuation for these 12 projects.

In April 1972, HUD issued revised guidelines to its field offices which, in part, prescribe new procedures for land appraisals. The revised guidelines state that land values are not to be based solely on

the sale price of comparable sites and that variances between the HUD appraisal and the owner's cost must be fully justified.

Sizable savings could be achieved if section 236 mortgage loans were financed by the Government rather than by private lenders because of the Government's more favorable interest cost. We estimate that for the housing planned to be provided by the section 236 program during fiscal years 1973–78, the present value of the savings could amount to about $1.2 billion.

Similar to the section 235 home assistance program, we are recommending that the Congress consider legislation which would permit the section 236 program to be financed by borrowings from the Treasury.

We examined the incentives being provided to investors in section 236 projects. Incentives provided to profit-motivated organizations are sufficient to initially attract a substantial number of prospective sponsors but do not appear adequate to encourage long-term ownership of projects. Such incentives include low initial investment, income tax shelters, and opportunity to profit from participation in other phases of project development and operation. The incentives are available to project owners regardless of how well or how poorly they manage a project.

There appear to be little incentives to encourage long-term ownership of projects. Tax shelters diminish rapidly after the 10th year of project ownership and the allowed 6 percent annual return on investment may not be sufficient to keep sponsors from disposing of their projects.

HUD stated that the development of incentives which encourage project retention or good project management should be stressed rather than reduction or shifting of production incentives, such as use of the builder-sponsor profit and risk allowance to meet investment requirements and special tax provisions. HUD plans to explore this possibility in depth.

Mr. Chairman, I have one additional observation to make regarding both the section 235 and the section 236 housing programs. On November 22, 1972, GAO issued a report to the Congress on the opportunity for reducing interest costs incurred by the Government under these programs. In that report, we pointed out that because HUD's monthly assistance payments include the mortgage insurance premiums, HUD is paying out funds which it must subsequently collect from the mortgagees. As a result, the Government loses the use of such funds for an average of 6 months. We estimated, for this fiscal year alone, that the interest cost to the Government on such monthly payments would be at least $1.6 million.

In our report, we recommended that the Congress authorize HUD to waive the mortgage insurance premium for the sections 235 and 236 housing programs similar to the waiver of premiums now provided for in the section 221(d)(3) rental housing program.

This concludes our oral statement, Mr. Chairman. The prepared statement has more detail on each of these points and I believe that has been made available to the press and others.

(The prepared statement of Mr. Staats follows:)

Prepared Statement of Hon. Elmer B. Staats

Mr. Chairman and members of the subcommittee: During the past 3 years, we have issued over 200 reports in the housing area, including reports on model cities, low-rent public housing, urban renewal, and mortgage insurance activities. This morning, I will discuss the results of two reviews we recently made of the manner in which the Department of Housing and Urban Development (HUD) and Agriculture have carried out housing subsidy programs. The complete results of both reviews will be published in reports to be issued within the next month.

As you know, these subsidy programs were started in 1968 and are designed to assist low- and moderate-income families in becoming homeowners or in paying lower rents. First, I will discuss our work on the homeownership assistance programs. Following that, I will present our views on the rental assistance program.

HOMEOWNERSHIP ASSISTANCE

The Department of Housing and Urban Development and the Department of Agriculture are authorized by section 235 of the National Housing Act and by section 502 of the Housing Act of 1949, as amended by the Housing Act of 1968, to assist low- and moderate-income families, through mortgage insurance and interest subsidies, to become homeowners. The purchase of either new or existing houses can be subsidized under these programs. The President's second annual report on housing goals (April 1970) estimated that about 2.8 million families will have received such assistance by 1978. The estimated cost to HUD will be in a range from $10 billion to $37 billion. As of June 30, 1972, HUD had expended about $379 million for homeownership assistance payments. No estimate was available as to Agriculture's eventual total cost. However, as of June 30, 1972, Agriculture estimated that its subsidy program had cost $37 million.

Because of the magnitude of Federal funds involved, the General Accounting Office reviewed major aspects of both programs to determine whether opportunities exist for HUD and Agriculture to improve program effectiveness and reduce costs. We reviewed the allocation of program resources, quality of housing provided, mortgage default rates, housing options provided, and method of financing the programs. Also, we considered recent comprehensive internal audits of the section 235 and section 502 programs by HUD and Agriculture.

Our review was generally confined to HUD and Agriculture activities in nine States where about 38 percent of the section 235 loans and about 29 percent of the section 502 loans were made. The complete results of our review will be published in a soon to be released report.

Our findings, conclusions, and recommendations in this area of housing assistance are as follows.

Need to improve allocation of program resources

HUD and Agriculture did not allocate program resources to insure that eligible families had the same opportunity to participate in the homeownership assistance programs regardless of where they lived.

The need for subsidized housing has not been adequately identified by either HUD or Agriculture. HUD headquarters estimated the need for subsidized housing; however, this estimate varied significantly from the need estimated by HUD field offices and the differences were not reconciled to arrive at reasonably reliable data. Neither Agriculture headquarters nor its field offices had developed estimates of rural subsidized housing needs as a basis for allocating program resources.

An area's capacity to produce housing has been a major factor influencing the distribution of HUD program resources at both the national and local levels. Allocation of Agriculture program resources at the national level has been based primarily on prior years' production activity and distribution at the local level has been primarily on a first-come, first-served basis. Agriculture makes subsidized and unsubsidized housing loans; however, it does not determine the specific needs of low-income families as a basis for an equitable allocation of funds for subsidized housing.

To illustrate the results of the above allocation processes, about 11 percent of the housing units provided by HUD through December 1971 were located in the northeastern States which would have received about 32 percent of the

housing units had they been allocated on the basis of HUD-estimated needs. Similarly, for Agriculture, about 10 percent of its housing units were located in the northeastern section of the Nation which had about 18 percent of the Nation's rural population. About 58 percent of the Agriculture housing units were located in the South which had about 41 percent of the total rural population.

Similar disparities existed at the local level, with some small cities and counties receiving no units, while some metropolitan areas in the same State received up to 190 percent of estimated needs.

We are recommending that HUD and Agriculture provide reasonable assurance that resources under sections 235 and 502 programs are allocated primarily in proportion to identified needs. We are recommending also that Agriculture make separate allocations for subsidized and unsubsidized housing loans in accordance with need.

In commenting on our findings, HUD stated that need factors were given greater weight in the fiscal year 1972 allocation formula. However, there are a number of States that have not received their proportionate share of the total subsidized housing units provided by HUD. We believe that HUD must first identify the true need for subsidized housing and make every effort to allocate program resources in accordance with the identified need.

HUD stated also that statutory mortgage insurance limitations, restrictive income limits, increasing land costs and taxes, and the conservative attitudes of some banking institutions contributed to the disparity between the estimated need for subsidized housing in the northeastern States and the housing units actually provided.

HUD agreed that field offices should take a more active role in determining areas' needs for subsidized housing and that priority should be given to the development of the areas.

Agriculture stated that the allocation of rural housing funds made to States takes into consideration factors such as number of rural homes, condition of homes, income of rural families, average cost of new homes and historical lending patterns, and that funds were distributed to States in accordance with need. Agriculture stated also that the States will be instructed to channel at least 50 percent of the allocation of rural housing section 502 funds into housing for low-income families.

Although the cited factors were taken into consideration when section 502 funds were distributed, we noted that historical lending patterns (prior production) have been a major factor influencing such distribution. For example, the initial distribution of fiscal year 1971 funds was based primarily on fiscal year 1970 distribution.

Agriculture advised us that for fiscal year 1973 it ranked the States for each of the five factors mentioned above and then adjusted the ranking based on "historical lending patterns" in order to decide whether a State should receive a greater or lesser proportion of the total program resources than it did the previous year. We believe that this procedure, emphasizing historical lending patterns, continues to give undue weight to prior production of housing instead of current needs for housing.

Also, we do not believe that an arbitrary 50 percent allocation would achieve the objective of our recommendation. We believe that allocations for subsidized loans should be made on the basis of specific determinations of need rather than on an arbitrary percentage.

CONDITION OF HOUSING

Our next finding deals with the condition of the housing being insured under the sections 235 and 502 programs.

Houses with significant defects were sold under the homeownership assistance programs. Because many of the housing defects concern the safety and health of the occupants, the objective of providing low- and moderate-income families with decent, safe, and sanitary housing was not met in many cases. Also, the families that obtained such houses could be faced with unexpected financial hardships in correcting the defects or could give up the houses because of dissatisfaction.

A report by the staff of the House Committee on Banking and Currency in December 1970 disclosed that houses with serious defects were provided to low- and

moderate-income families under the section 235 program. As a result of the committee staff report, the HUD office of audit made a nationwide review of HUD's administration of the section 235 program which included the physical inspection of 1,281 properties selected on the basis of a statistical random sample. HUD auditors found that about 24 percent of the new houses and about 39 percent of the existing houses had significant defects.

We reviewed the HUD auditors' sampling techniques and verified their inspection results by inspecting with them, or by reinspecting, a selected number of houses in their sample. On the basis of our review of the HUD audit work, we believe that the results of the inspections can be projected nationwide. Such a projection indicates that about 18,900 new houses and about 15,800 existing houses provided by the section 235 program as of November 30, 1970, had defects.

HUD inspection procedures, which are supposed to prevent defective houses from being insured, were inadequate because (1) appraisers had not been adequately trained to make inspections, (2) the emphasis on providing houses had placed an unusually heavy workload on appraisers, (3) appraisers were not adequately supervised, and (4) field office personnel did not adjust their thinking and attitudes to encompass the consumer-oriented needs of the new program.

We inspected 121 houses in eight states under the agriculture administered sections 235 and 502 programs and found that over 50 percent had defects similar to those found in the HUD section 235 program. Agriculture officials advised us that houses with defects have been provided because the houses were inspected by county supervisors who were not qualified as housing inspectors.

HUD and Agriculture have taken certain corrective actions and planned to take others. At the time of our review, it was too early to test the adequacy of these actions.

Purchasers of *new* houses under sections 235 and 502 are protected against defects by homeowner service policies which require builders to correct defects disclosed during the first year after purchase.

This type of protection was not available to purchasers of *existing* section 235 housing until December 31, 1970, when the National Housing Act was amended to permit HUD to correct defects which seriously affect the use and livability of any existing house provided under section 235. Also, HUD now requires a seller of an existing house to certify the present condition of the House, and if he is not the most recent occupant, deposit 5 percent of the sale proceeds in escrow for 1 year to assure reimbursement to HUD, should repairs be needed.

Similar protection for purchasers of existing housing under section 502 is not available.

Because low-income families are often unable to detect housing defects and have them corrected, we are recommending that HUD and agriculture reinspect all houses within 1 year after purchase to insure that defects covered by builder service policies and seller certifications have been identified and corrected.

We are also recommending that the Secretary of Agriculture implement procedures or seek legislation, if considered necessary, to insure that Agriculture and/or the purchaser of existing housing has recourse to the seller to cover the cost of repairing defects that existed at the time of sale.

In commenting on our recommendation to reinspect houses, HUD pointed out the increased workload that would be imposed by such a requirement and, since its budget would not cover the additional staff needed, it might have to use private fee inspectors. Agriculture stated that, if appropriations permit, it would put into effect a requirement for reinspection of all houses during the eleventh month of the 1-year warranty period.

Agriculture stated that it would study our recommendation that purchasers of existing housing under the section 502 program be protected by a right of recourse to the seller.

HOUSING OPTIONS

Our next finding deals with the need for defining the housing features (options) available under the section 235 and section 502 programs.

HUD and agriculture did not provide their field offices with adequate guidelines defining the type of housing eligible under homeownership assistance programs for low- and moderate-income families. As a result, some families could buy homes with options such as air conditioning, fireplaces, or extra bedrooms, while other families in the same general area were unable to obtain these options. Because of these inconsistencies, neither agency could insure that all eligible

families were offered the same opportunity to receive the extent of assistance intended by the Congress nor could the two agencies insure that program costs are minimized so that the maximum number of families are assisted with the available funds.

We are recommending that HUD and agriculture (1) clearly define the type of housing options that will be made available under homeownership assistance programs in the various areas of the nation and (2) jointly determine what housing options are appropriate for inclusion in houses being provided in communities served by both departments.

HUD referred to guidelines that it issued subsequent to the period covered by our review which clarify previous instructions regarding mortgage ceilings. We believe that these guidelines could meet the objective of our first recommendation; however, at the time of our review it was too early to make that determination.

Agriculture recognized that significant variations exist between counties with respect to the type of construction and the housing options made available to low-income purchasers. In June 1972, it instructed state directors to reconcile differences and issue guidelines to assure a consistent application of the policy of financing adequate but modest housing. We believe that implementation of these instructions could meet the objectives of our first recommendation; however, it is too early to make that determination.

HUD did not comment on our second recommendation. Agriculture stated that there would be little advantage to establishing a joint HUD/Agriculture list of housing options because HUD and Agriculture serve different markets. We agree that HUD and Agriculture generally do serve different markets; however, under section 235 and 502 programs, houses are sometimes provided in the same market area. Under these circumstances, we believe that HUD and Agriculture should agree on what options should be made available under both programs.

MORTGAGE DEFAULTS

We also reviewed the mortgage defaults rates on the section 235 and section 502 programs.

Preliminary information indicates that mortgage defaults could become a major problem for the section 235 program. The number of defaults in the section 502 program has been low to date; however, Agriculture officials anticipate that increased program activity will result in a marked increase in the default rate. A high default rate would reduce program effectiveness and could result in significant costs to manage and dispose of acquired properties. We believe HUD and Agriculture should take precautionary steps to analyze anticipated default patterns and identify possible ways of keeping the rate down.

We examined the initial default experience at 10 HUD field offices and found a range from a low of about 2.2 percent in one office to 20.1 percent in another. Although a precise default rate for the section 235 program has not been developed, the pattern of defaults thus far closely parallels HUD's experience on another mortgage insurance program for low- and moderate-income families which shows a default rate of about 11 percent after 9 years.

At June 30, 1972, HUD had incurred an average loss of about $3,835 to manage and dispose of each acquired section 235 property, for a total loss of about $15.2 million. Data provided by HUD's actuaries indicate that the average loss will be even higher in the future. However, if the average loss was to remain the same, and the default rate reaches 10 percent on the 1.4 million properties to be insured through fiscal year 1978, HUD would eventually incur losses of about $532 million to manage and dispose of acquired section 235 properties.

At the time of our review the number of acquired section 502 properties was increasing. Only 251 properties had been acquired by Agriculture through 1969, the first 19 years of the basic section 502 program. An additional 184 properties were acquired in the next year.

HUD has established a procedure for continuous review of the reasons for default and recently initiated a counseling program for section 235 applicants in some of its field offices. Also, Agriculture informed us that its regulations provide for a case-by-case evaluation of delinquencies and the reasons for them.

We believe that these procedures are not adequate to obtain a useful analysis of all significant factors relating to defaults. We are recommending, therefore,

that HUD and Agriculture require in-depth studies to determine the major reasons for defaults and use the results to develop guidelines for screening and counseling program applicants.

METHOD OF FINANCING

Our last observation concerns the method of financing HUD's homeownership program. We estimate that the present value of the savings on the section 235 program could amount to about $1 billion if loans were financed directly by the Government rather than by private lenders because of the lower interest cost at which the Government could borrow funds.

In a previous GAO report to the Congress in July 1971, we recommended that the Congress consider amending the legislation pertaining to the section 502 program to require direct Federal financing, and we are now recommending that the Congress consider similar legislation for the section 235 program.

Comments regarding the method of financing the section 235 program were obtained from the Department of the Treasury and the Office of Management and Budget (OMB), as well as HUD.

HUD and Treasury commented that direct Federal financing of the section 235 program would result in a larger Federal budget and increased cash flow from the Treasury. HUD estimated the amount to be about $3.5 billion for fiscal year 1973. We agree that the budget for the section 235 program would be increased if direct Federal financing is approved.

We also agree that direct Federal financing would initially result in increased cash flows from the Treasury. However, this is only true during the early years. Because of the more favorable interest rates for Government borrowing, the direct method of financing for the section 235 program will result in a net cost reduction of about $1 billion without increasing the cost of housing for low-income family purchasers.

HUD stated that substantial staff increases would be required to process loan applications and to establish and maintain accounting records and reports. Our review indicated that most mortgagees involved in the section 235 program would be willing to perform these services at no increase in cost over that incurred under the present method of financing. In these circumstances, substantial staff increases would not be needed.

OMB expressed the view that the Government should not seek a major role as a direct lender when the private economy can perform this function effectively. We believe that this is a fundamental question to be considered by the Congress in determining whether to approve direct Federal financing of the section 235 program.

RENTAL ASSISTANCE

Now let us turn our attention to the rental assistance program.

Providing adequate rental housing for low- and moderate-income families is one of the major issues facing the Nation today. To increase the number of rental housing units available to these families, a mortgage insurance program was authorized by section 236 of the National Housing Act. Under the program, HUD provides financial assistance by paying the mortgage insurance premiums and a portion of the interest costs. HUD interest subsidy payments make possible lower rents to the tenants.

By 1978, an estimated 1.3 million units of rental housing are to provided by the section 236 program. The HUD interest subsidy payments under this program could range from $20 billion to $49 billion.

Because of the magnitude of the Federal funds involved, we examined the administration and operation of the section 236 housing program. We reviewed the procedures and practices followed by HUD in allocating program resources. Appraising land selected for projects, and assisting and monitoring project management. We reviewed also the method of financing the program, the quality of project construction, and the various program incentives to determine whether they were sufficient to bring enough private capital into the program to meet section 236 objectives. Also, we considered a recent comprehensive internal audit of the section 236 program by HUD.

Our review was generally confined to HUD activities in four states—Georgia, Texas, California, and New York. The complete results of our review will be published in a soon to be released report.

Our tentative findings, conclusions, and recommendations in this area of housing assistance are as follows.

Need to improve allocation of program resources

I previously discussed the need for improving procedures in the allocation of section 235 program resources and our recommendation that HUD provide a better identification of the need for subdized housing in specific areas and communities and assure that section 235 resources are allocated primarily in proportion to identified needs.

Because the same general deficiencies were observed in the allocation of section 236 program resources, we are recommending that HUD provide a better identification of housing needs and assure that section 236 resources are allocated primarily in proportion to identified needs.

In commenting on our finding, HUD stated that the allocation system has continually been refined to make it more objective, equitable, and accurate and that the system provides maximum equity among the HUD field offices. HUD stated also that it does not initiate housing production and does not attempt to force housing in any area. However, there are a number of States and housing market areas which have not received their proportionate share of the total subsidized housing units provided by HUD. As in the case of the section 235 program, we believe that HUD must first adequately identify the need in all areas and then make every effort to allocate program resources in accordance with the identified need.

HUD stated that it has been informing industry and communities on the benefits of the section 236 program and is considering additional means to stimulate productivity where it is most appropriate.

Action taken to strengthen land appraisal procedures

Our next point deals with the land appraisals that were being made by HUD for section 236 projects. Because HUD did not give adequate consideration to purchase price or option price data, its appraisals of land to establish section 236 mortgage loan amounts may have unduly increased mortgage loans, resulting in higher interest subsidy costs to the government, and probably higher rents to project tenants.

In determining the amount of an insured mortgage loan for multifamily housing, such as a section 236 project, HUD estimates the replacement cost of the project, including the fair market value of the improved land. For a profit-motivated project owner, the insured mortgage loan amount is generally limited to 90 percent of a project's estimated replacement cost, and for nonprofit project owners the insured mortgage loan amount may equal 100 percent of replacement cost.

At the time of our review, HUD determined the value of a proposed project site by measuring it against comparable sites (usually five) which had been recently sold or offered for sale and which had elements of utility and desirability similar to the proposed site. To bring the other sites and their prices into proper perspective with the site being appraised, HUD adjusted the prices of the comparable sites to compensate for location, time, zoning, size, and offsite improvement differences.

We examined the land valuation assigned to 68 recently completed section 236 projects administered by HUD field offices in Atlanta, Dallas, and Los Angeles. Each of the field offices used the aforementioned HUD procedures in valuing land for mortgage loan purposes and generally had not considered the actual cost to the owner as one of the valuation criteria. Project land was valued by HUD above its cost to the owner for 47 of the 68 projects. For 12 of the 47 projects, HUD valued the land at 125 percent or more of the owner's cost, and the valuations had been made within 24 months of the owner's acquisition of the land. Five of these HUD valuations involved land which the project sponsors did not yet own—they only had purchase options. A table showing the variations between the owner's cost and HUD's valuation for these 12 projects is provided in appendix I of this statement.

When HUD assigns a value to project land in excess of its cost to the project owner, the owner realizes a gain which, in the case of a profit-motivated owner, can be used to meet equity investment requirement. We estimate that the differ-

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ence between HUD's valuation and the cost of land for the 12 projects could increase HUD's interest reduction payments by about $2 million over the life of the 12 mortgage loans.

In April 1972, HUD issued revised guidelines to its field offices which, in part, prescribe new procedures for land appraisals. The revised guidelines state that land values are not to be based solely on the sale price of comparable sites and that variances between the HUD appraisal and the owner's cost must be fully justified.

We believe these guidelines, if properly implemented, should improve HUD's land appraisal techniques and help assure that a reasonable value is given to project land for mortgage loan purposes. However, we are recommending that HUD initiate a field monitoring system to periodically review the field offices' land valuation practices.

In commenting on our finding, HUD stated that there should be little concern for the possibility of windfall profits on land if its land appraisal procedures, which are based on sound appraisal principles and practices, are followed. HUD agreed that the field offices' compliance with the appraisal guidelines need to be monitored.

Method of financing

Our next finding on the section 236 program concerns the method of financing the program.

Sizable savings could be achieved if section 236 mortgage loans were financed by the government rather than by private lenders because of the government's more favorable interest cost. We estimate that for the housing planned to be provided by the section 236 program during fiscal years 1973–1978, the present value of the savings could amount to about $1.2 billion. Government financing of section 236 loans would, of course, require a larger annual budget outlay—estimated at about $3 billion annually during the 6-year period 1973–1978—than would be required by the present method of financing the program.

As for the section 235 homeownership assistance program, we are recommending that the Congress consider legislation which would permit the section 236 program to be financed by borrowings from the treasury. In this regard, we recognize that there are factors other than costs, such as the impact on the Federal Budget, which must be considered in determining which method of financing is most appropriate for a particular mortgage credit program. However, we believe that the Congress should be made aware of the substantial savings that could be achieved by the government as a result of an alternative method of financing the section 236 program, so that the Congress may take such action as it deems appropriate.

The department of treasury, the office of management and budget, and HUD took the same position regarding the financing of the 236 program as expressed in their comments on our recommendation for the section 236 program.

Incentives to investors

We examined the incentives being provided to investors. Incentives provided to profit-motivated organizations to invest in section 236 projects are sufficient to initially attract a substantial number of prospective sponsors but do not appear adequate to encourage long-term ownership of projects. Such incentives include low initial investment, income tax shelters, and opportunity to profit from participation in other phases of project development and operation. The incentives are available to project owners regardless of how well or how poorly they manage a project.

To obtain a HUD-insured mortgage loan, a profit-motivated owner of a section 236 project is required to have at least a 10 percent investment in the project, based on the project's estimated replacement cost.

A project owner's cash investment in a project, however, may be substantially less than 10 percent of the project's replacement cost because of increased land valuation and certain allowances which HUD permits project owners to use to meet the investment requirement. For example, if the project owner is also the general contractor for the project, HUD permits the owner to use the builder-sponsor profit and risk allowance—an amount equal to 10 percent of the estimated construction cost which is included in the project's replacement cost—to meet the investment requirement.

Incentives to invest in federally subsidized multifamily housing have been provided in the form of tax shelters that may be used to reduce Federal income

tax liabilities. Some of the tax incentives include accelerated depreciation, more liberal provisions for the recapture of accelerated depreciation in event of sale, 5-year write-off of rehabilitation costs, deferment of taxable gain when it is reinvested in other subsidized housing, and allowance of a fair market value rather than depreciated cost as a deductible item when housing is donated to qualified charitable organizations.

The owner of a section 236 project may also profit from participation in other phases of the construction and management of a project. The project owner can have financial interest in an architecture firm which designs the project and in firms which do work for the general contractor on a subcontract basis.

Many project owners also own real estate management firms which can be used to provide the project with management, custodial, and bookkeeping services.

There appear to be little incentives to encourage long-term ownership of projects. Tax shelters diminish rapidly after the tenth year of project ownership and the allowed 6 percent annual return on investment may not be sufficient to keep sponsors from disposing of their projects.

We obtained comments from Treasury and HUD on the effectiveness of present incentives. Treasury stated that it is not at all clear that the various tax incentives encourage project owners to sell housing projects. However, HUD stated that the incentives have influenced significantly the motivation of profit-motivated owners and that there appears to be little incentive to continue ownership after the initial 10-year period.

Treasury agreed that there are a number of problems associated with a subsidy program which requires tax incentives to make it go. HUD stated that the development of incentives which encourage project retention or good project management should be stressed rather than reduction or shifting of production incentives, such as use of the builder-sponsor profit and risk allowance to meet investment requirements and special tax provisions. HUD plans to explore this possibility in-depth.

Other program observations

Other section 236 program observations that we made during the course of our review include:

Instances of incorrect rent charges and the failure of project owners to turn back rent collections exceeding base rent to HUD,

The quality of the housing units inspected was generally found to be good,

HUD did not have adequate data with which to make a comprehensive analysis of estimated operations and maintenance costs of proposed section 236 projects, increasing the possibility of approving projects which are too costly to meet the needs of lower income families, and

The amounts allowed by the Dallas field office for legal and organizational fees during the development stage of section 236 projects were higher than the amounts suggested by HUD guidelines.

HUD has indicated that corrective action, where appropriate, is being taken regarding these matters.

Mr. Chairman, I have one additional observation to make regarding both the section 235 and section 236 programs. On November 22, 1972, GAO issued a report to the Congress on the opportunity for reducing interest costs under sections 235 and 236 housing programs. In that report, we point out that because HUD's monthly assistance payments include the mortgage insurance premiums, HUD is paying out funds which it must subsequently collect from the mortgagees. As a result, the Government loses the use of such funds for an average of 6 months. We estimated, for this fiscal year alone, that the interest cost to the Government on such monthly payments would be at least $1.6 million.

In our report, we recommended that the Congress authorize HUD to waive the mortgage insurance premium for the sections 235 and 236 housing programs similar to the waiver of premiums now provided for in the section 221(D)(3) rental housing program.

In addition to the above observations concerning the subsidized housing programs, we would like to respond to the chairman's request for information on insurance written and the incidence of defaults and foreclosures in the past 3 years under the various HUD-insured mortgage loan programs and the estimated costs to the Federal Government of such foreclosures. This information is provided in appendixes II through VII of this statement.

This concludes my prepared statement, Mr. Chairman. We shall be pleased to respond to any questions the members of the subcommittee may have.

APPENDIX I.—VARIATIONS BETWEEN OWNER'S COST AND HUD VALUATION OF SEC. 236 PROJECT LAND

HUD field office	Project land			Months between purchase or option agreement and HUD valuation
		HUD valuation		
	Cost [1]	Amount	Percentage of cost	
Atlanta	$61,400	$157,000	256	3
	22,503	75,000	333	17
	72,502	96,000	132	2
Dallas	[2] 149,750	311,500	208	7
	[2] 116,320	250,000	215	6
	[2] 125,886	235,200	187	4
	[2] 116,520	223,700	192	8
	[2] 260,020	356,000	137	1
Los Angeles	317,400	415,080	131	17
	158,000	228,600	145	7
	271,407	341,000	126	17
	198,800	251,500	127	11

[1] Includes estimated cost of offsite improvements, demolition, and other related land improvements.
[2] The sponsors of these projects held purchase options at the time of the HUD appraisals.

APPENDIX II.—TOTAL MORTGAGE INSURANCE WRITTEN FOR HOMEOWNERSHIP PROGRAMS, FISCAL YEARS 1970, 1971, AND 1972 AND CUMULATIVE THROUGH JUNE 30, 1972

Section or title of the act	Insurance written in fiscal year—						Cumulative insurance written through June 30, 1972	
	1970		1971		1972			
	Number of loans	Amount (thousands)	Number of loans	Amount (thousands)	Number of loans	Amount (thousands)	Number of loans	Amount (thousands)
Sec. 203	268,962	$4,668,088	297,272	$5,515,934	276,819	$5,399,269	8,750,423	$100,886,614
Sec. 221	53,087	734,998	86,913	1,385,403	87,690	1,509,664	539,327	6,948,986
Sec. 222	8,666	149,454	9,981	187,827	9,472	194,071	245,892	3,618,900
Sec. 223e	34,397	449,115	25,597	355,871	17,070	259,444	101,236	1,365,383
Sec. 235	49,622	757,274	140,548	2,499,456	135,122	2,501,612	330,070	5,825,938
Title VI [1]	0	0	0	0	0	0	628,835	3,663,998
Sec. 809	251	5,357	247	5,405	234	5,328	16,162	261,518
All others [2]	3,734	54,027	5,287	54,607	6,876	115,690	155,877	1,518,100
Total	418,719	6,818,313	565,845	10,004,503	533,283	9,985,078	10,767,822	124,089,437

[1] Includes secs. 603, 609, and 611.
[2] Includes secs. 8, 203k, 213, 220, 221(h), 225, 237, and 903.

APPENDIX III.—TOTAL PROPERTIES AND NOTES ACQUIRED UNDER HOMEOWNERSHIP PROGRAMS, FISCAL YEARS 1970, 1971, AND 1972 AND CUMULATIVE THROUGH JUNE 30, 1972

Section or title of the act	Properties and notes acquired in fiscal year—						Properties and notes acquired through June 30, 1972	
	1970		1971		1972			
	Number	Amount (thousands)	Number	Amount (thousands)	Number	Amount (thousands)	Number	Amount (thousands)
Sec. 203	19,177	$310,247	20,128	$345,801	22,797	$438,732	331,810	$4,720,060
Sec. 221	4,957	73,233	7,133	115,821	12,099	220,969	51,821	752,931
Sec. 222	982	15,781	743	11,818	589	10,032	21,582	303,192
Sec. 223	920	12,066	3,134	47,352	4,432	73,478	8,509	133,125
Sec. 235	282	4,091	3,679	60,094	13,164	233,156	17,128	297,377
Title VI [1]	11	77	2	79	1	(15)	12,285	81,578
Sec. 809	152	2,803	131	2,381	68	1,437	1,373	22,546
All others [2]	212	3,704	290	4,031	247	5,257	24,739	278,783
Total	26,693	422,002	35,240	588,377	53,397	983,046	469,247	6,589,592

[1] Includes secs. 603, 609, 611.
[2] Includes secs. 8, 203k, 213, 220, 221(h), 225, 237, 903.

APPENDIX IV.—HOME PROPERTIES SOLD AND ASSIGNED NOTES LIQUIDATED AS OF JUNE 30, 1972

Section of the act	Properties sold		Assigned notes liquidated		Total properties and assigned notes liquidated		Average loss per case
	Number	Net loss to fund (thousands omitted)	Number	Net loss to fund (thousands omitted)	Number	Net loss to fund (thousands omitted)	
Sec. 203	308,002	$872,900	161		308,163	$872,900	$2,833
Sec. 213	4,574	16,173	3		4,577	16,173	3,534
Sec. 221	38,463	142,480	8		38,471	142,480	3,704
Sec. 222	21,163	57,847	4		21,167	57,847	2,733
Title VI [1]	11,926	12,030	125	$61	12,051	12,091	1,003
Sec. 903	16,295	60,095	8		16,303	60,095	3,686
Sec. 223(e)	2,736	17,703			2,736	17,703	6,470
Sec. 235	3,974	15,245	1		3,975	15,245	3,835
Sec. 237	52	317			52	317	6,096
Others [2]	4,031	7,248	15	53	4,046	7,301	1,804

[1] Includes secs. 603, 609, and 611.
[2] Includes secs. 2, 8, 203(k), 220, 223, 234, and 809.

APPENDIX V.—TOTAL MORTGAGE INSURANCE WRITTEN FOR MULTIFAMILY PROPERTIES, FISCAL YEARS 1970, 1971, AND 1972 AND CUMULATIVE THROUGH JUNE 30, 1972

Section or title of the act	Total insurance written for fiscal year: 1970 Number of loans	1970 Number of units	1970 Amount (thousands omitted)	1971 Number of loans	1971 Number of units	1971 Amount (thousands omitted)	1972 Number of loans	1972 Number of units	1972 Amount (thousands omitted)	Cumulative insurance written through June 30, 1972: Number of loans	Number of units	Amount (thousands omitted)
Sec. 207	78	11,347	$86,068	266	42,052	$285,648	187	30,681	$332,535	2,466	321,069	$3,566,267
Sec. 213	4	112	2,915	0	0	0	0	0	0	1,536	46,988	651,528
Sec. 220	11	1,030	25,062	20	2,639	57,854	11	3,833	93,085	363	66,910	1,242,592
Sec. 221	621	58,421	831,754	673	68,974	1,010,133	754	84,147	1,283,333	3,736	414,906	5,801,275
Sec. 236	473	59,987	901,804	985	104,907	1,740,744	1,043	111,323	1,843,621	2,509	277,592	4,504,050
Title VI [1]	0	0	0	0	0	0	0	0	0	7,103	472,791	3,463,560
Title VIII [2]	0	0	0	0	0	0	0	0	0	1,187	208,151	2,631,283
All others [3]	435	7,304	215,761	402	8,530	453,259	386	32,013	478,950	2,955	281,194	3,117,003
Total	1,622	138,201	2,063,364	2,346	227,102	3,547,638	2,381	261,997	4,031,524	21,855	2,089,511	24,977,558

[1] Includes secs. 608, 609, 610, and 611.
[2] Includes secs. 803 and 810.
[3] Includes secs. 220(h), 221(h), 223(d), 231, 232, 233, 234, 241, 242, 908, 1002, 1101, 223(e), 235(j), and 213.

APPENDIX VI.—MULTIFAMILY PROPERTIES AND NOTES ACQUIRED UNDER TERMS OF INSURANCE CONTRACTS FISCAL YEARS 1970, 1971, AND 1972 AND CUMULATIVE THROUGH JUNE 30, 1972

Title or section of the act	Properties and notes acquired: 1970 Number	1970 Units	1970 Amount [1] (thousands omitted)	1971 Number	1971 Units	1971 Amount [1] (thousands omitted)	1972 Number	1972 Units	1972 Amount [1] (thousands omitted)	Properties and notes acquired thru June 30, 1972: Number	Units	Amount [1] (thousands omitted)
Sec. 207	5	855	$7,206	10	1,310	$10,965	8	1,080	(2,011)	260	38,843	$366,123
Sec. 213			(4,481)			(2,212)	1	169	480	80	8,746	125,192
Sec. 220			(5,233)	6	1,203	13,245	4	1,276	30,543	47	10,036	148,107
Sec. 221	29	1,929	18,322	62	6,081	76,212	94	10,627	134,524	245	26,552	299,798
Sec. 236				7	887	13,109	29	2,416	30,965	36	3,303	44,074
Title VI [2]	7	707	(1,894)	3	291	(3,171)	7	87	(3,242)	1,001	69,600	384,964
Title VIII [3]			(397)			(1,519)	1	70	717	66	9,878	96,152
All others [4]	6	387	(3,534)	26	2,924	25,250	23	1,708	9,708	192	23,422	258,428
Total	47	3,878	9,989	114	12,696	131,877	167	17,433	201,684	1,927	190,380	1,722,838

[1] FHA as part of its operation of the properties acquired through foreclosure or assignment of mortgage notes collects rents and pays operating expenses. Figures in parentheses are balances by which rent collections exceeded operating expenses.
[2] Includes secs. 608, 609, 610, and 611.
[3] Includes secs. 803 and 810.
[4] Includes secs. 220(h), 221(h), 223(d), 231, 232, 233, 234, 241, 242, 908, 1002, 1101, 223(e), 235(j) and 213.

APPENDIX VII.—MULTIFAMILY PROPERTIES SOLD AND ASSIGNED NOTES LIQUIDATED AS OF JUNE 30, 1972

Section of the act	Properties sold		Assigned notes liquidated		Total properties and notes assigned		Average loss per unit
	Units	Net loss to fund	Units	Net loss to fund	Units	Net loss to fund	
Sec. 207	16,577	$13,849,975	2,998	$283,518	19,575	$14,133,493	$722
Sec. 213	4,531	7,265,593	1,016	3,226,346	5,547	10,491,939	1,891
Sec. 231	6,533	16,751,543	575	(567,629)	7,108	16,183,914	2,277
Sec. 221	2,807	2,032,249			2,807	2,032,249	724
Sec. 608	45,213	70,627,505	5,301	1,511,476	50,514	72,138,981	1,428
Title VIII [1]	3,698	15,289,967	2,920	2,790,844	6,618	18,080,811	2,732
Other [2]	4,912	817,548	910	364,254	5,822	1,181,802	203
Total	84,271	126,634,380	13,720	7,608,809	97,991	134,243,189	

[1] Includes secs. 803 and 810.
[2] Includes secs. 232, 220, 234, 908, 213, and 609.

Chairman PROXMIRE. Thank you, Mr. Staats, for accommodating your presentation to the needs of our subcommittee this morning because as you know, we do have this distinguished panel following you.

This is a startling and shocking statement. You have given us a great deal of critical material about the management of these programs that brings me to the conclusion that these programs have been handled very badly, at great unnecessary cost to the taxpayer, and to those people who need housing, the poor especially, low-income people who are not getting housing and are having to pay much more for it than they should.

Can you give me the details, if you have them, State by State, or if not, region by region of the allocation of subsidized homeownership and rental unit programs, both 235, 236, and 502?

Mr. STAATS. I am not sure——

Chairman PROXMIRE. You give us part of this in your basic statement here. You pointed out that the Northeast part of our country got far less than it would seem to deserve on any kind of criteria. The South got far more than it should.

Mr. STAATS. Yes; there are several conditions peculiar in New England which have accounted for this, in part, we think. The statutory mortgage limitation, land costs, and taxes have played a part in that situation. Mr. Birkle, I believe, can respond in more detail to your question.

Chairman PROXMIRE. Well, what I want to know is how this allocation compares State by State and also how it compares with the HUD's need formula, I understand they have a need formula.

Mr. STAATS. You mean in all 50 States?

Chairman PROXMIRE. To the extent you have. I would not expect you would have it in that detail.

Mr. BIRKLE. Mr. Chairman, we do have that information, it will be in the appendix of our report when it is issued in a few weeks, State by State matching needs with allocations.

Chairman PROXMIRE. If you do not have it now can you tell me, in the first place, what does the Northeastern part of our country, what does it consist, how far north and how far west does it go?

Mr. BIRKLE. It is basically the New England States, New York and Pennsylvania.

Chairman PROXMIRE. New England, New York and Pennsylvania?

Mr. BIRKLE. I think also New Jersey.

Chairman PROXMIRE. So you have no comment in here or anything you can tell us this morning on any other section of the country except that part and the South, is that right?

Mr. BIRKLE. That is right.

Mr. STAATS. It includes all the New England States plus New Jersey, New York, and Pennsylvania.

Chairman PROXMIRE. Could we conclude that on the basis of the criteria that HUD is using; that is, especially you mentioned past production as a criteria, could we assume that this might result in serious distortion in the rest of the country, too?

Mr. STAATS. Yes, sir.

Mr. BIRKLE. We have evidence of past production in some areas, in the South and Southwest where they responded primarily to requests from builders and developers for fund allocations to provide projects and homes, and it has resulted in some overproduction.

Chairman PROXMIRE. Exactly where did HUD management break down so that these subsidized housing programs were not directed to the intended beneficiaries?

Mr. BIRKLE. Well, I think the area of breakdown is primarily because of the emphasis on production. We had housing goals that were established. HUD felt that these were essential to meet and, as a result, in order to meet the goals the quality of inspections that they were making was reduced. Inspectors were required to inspect as many as 15 or 20 houses a day in some areas of the country, and as a result they missed a lot of defects, and I think that the emphasis in HUD on production has been the primary cause of poor management in other areas of the program.

Chairman PROXMIRE. Why was the staff deficient? Did HUD and the White House cut the staff? Could they have met the goals if they had used the funds that were appropriated?

Mr. BIRKLE. There were no increases in staff of any significance and, of course, recently we did have a reduction when HUD reorganized. Also, HUD has transferred a lot of responsibility out to the field.

Chairman PROXMIRE. Could it be said fairly and accurately that this reduction in staff actually cost money? It may have saved some money in salaries but that it cost money inasmuch as you did not have the inspectors there who would have saved money in the long run?

Mr. BIRKLE. Well, to the extent that we are acquiring homes today through foreclosures that we would not be acquiring had adequate inspections been made, I would say it did cost money.

Chairman PROXMIRE. It is a generalization and I think we can all agree with that but I wonder if you have any specific finding on that that there is actually a loss on this thing or you just conclude that is likely?

Mr. BIRKLE. Well, we provide figures on the amount that HUD would stand to lose eventually under the 235 program if they foreclose on, say, 10 percent of the homes that have been insured.

Chairman PROXMIRE. You have figures indicating that you lose half a billion dollars by 1978, is that not right?

Mr. BIRKLE. Yes, sir; by 1978.

Chairman PROXMIRE. And it is inconceivable that the cost of the staff would even be a significant fraction of that, right?

Mr. BIRKLE. That would be right.

Chairman PROXMIRE. So there is no question that this was a foolish policy so far as the taxpayers are concerned.

Do you have any advice, Mr. Staats, as to what Congress can do to better distribute these subsidized housing units? You say something about that but would you like to affirm it now?

Mr. STAATS. To better what, Mr. Chairman?

Chairman PROXMIRE. Better distribute these subsidies so that it is fairer and more effective so far as need.

Mr. STAATS. Well, HUD has recently taken action to give greater emphasis to need factors—about 60 percent, I believe, is their test now as contrasted with other factors in the allocation formula. We do not believe that Agriculture has taken any formal action in this respect.

I do not know that we have any specific suggestions to give to the committee or to the Congress on this precise point except perhaps to hold a hearing of this type and emphasize that that was the basic objective of the statute.

Chairman PROXMIRE. Let me ask you—in your studies—you make an estimate that the present value of the savings under section 235 homeownership program for all those units initiated between fiscal 1973 and fiscal 1978 would be about $1 billion—a billion dollars of savings if the loans were financed directly by the Government. This is because of the lower interest cost at which the Government can borrow funds. You go on to recommend that the Congress should consider switching to direct loans as a result of your findings.

My understanding is that your estimates of the savings of subsidy funds for the 235 homeownership program were based on a Government interest rate comparable to long term Government borrowing, or about 6.5 percent. What would be the savings to the Government if the rate used was the average rate of interest on all outstanding Government securities?

Mr. STAATS. Mr. Birkle, do you want to answer that?

Mr. BIRKLE. It would be more than twice that amount.

Chairman PROXMIRE. So it would be more than $2 billion, perhaps $2½ billion?

Mr. BIRKLE. That is right.

Chairman PROXMIRE. Then you estimate the Government could save about $1.2 billion on the 236 rental subsidy if it switched to direct loans. What would be the savings if the estimates were based on the average rate of interest for all outstanding Government securities?

We said between $1 billion and $2½ billion, depending on your assumptions for 235. With the rental program, you say it would be $1.2 billion in addition. What would be the savings if the estimate were based on the outstanding rates of interests for all 236?

Mr. BIRKLE. The same would be true; it would be more than twice as much.

Chairman PROXMIRE. So that would be around $2½ billion, maybe more.

In your prepared statement, you go on to indicate that shifting to direct loans would mean a larger Federal budget and increased cash

flow from the Treasury. I take it that this is true in the short run but that in the long run, in fact, the Treasury is going to save significantly. Would you explain, Mr. Staats, why the budget costs would increase in the short run but be less over the lifetime of the program?

Mr. Staats. Well, the cash flow in the short period would be on the outgoing side, I think that would be perfectly understandable, but over the longer period of time, as repayments took place, this would even itself out. Where the savings arise are in the differential in the interest rates. So it is quite understandable that Treasury and OMB would have a position which would try to minimize the budget outlays during a short-term period.

Chairman Proxmire. But it seems to me this is such a striking difference, enormous increase in costs to the taxpayer. I read your prepared statement, you indicated the reasons OMB gave, and I understand their reasons. In addition to the effect on the budget, they felt the private sector should handle anything it can handle, but at this fantastic cost of at least $1 billion and perhaps $2 billion, and more, on 235, and then more than that on 236, it seems to me that this is a whale of a lot to pay for a theory or philosophy that does not seem to have any solid justification.

Mr. Staats. Well, we have two points that we would make, Mr. Chairman, I think, overall. One is that the savings here are real—there is no question about it—that the Government can borrow money in the market at a lower rate of interest, and the second point is that anything which can be done to reduce the cost of this program is in the long run going to be in line with the objectives of the statute itself, which is to provide low-cost housing for low- and middle-income groups.

Chairman Proxmire. About 4 or 5 years ago, the President decided to change our budget from an administrative budget to a unified budget, and that was a great change and reform. It seems to me there were some reasons for that and they were pretty good. But I think that the reasons for changing now, just in this area alone, would eminently justify considering a capital budget. I think the public would understand it. Every business has it. It is ridiculous for us to put loans in exactly the same category as expenditures. Is this not the guts of it here? Is this not the reason for it? We make a loan, we classify it, because it is a money outlay, as an expenditure. If, instead, we had a capital budget, so that everybody would understand these are loans that are repayable with interest, and so forth, then we would escape from this ridiculous trap we put ourselves into—and it is not partisan; it is bipartisan. Democrats made just as many mistakes longer than perhaps the Republicans did; we had control of the Congress. It is an idea whose time has come and your report here dramatizes that.

Mr. Staats. Mr. Chairman, incidentally, we do have a detailed analysis for both the 235 and 236 savings in this respect which I believe you might be interested in having for the record. This is a very complicated subject as to how you arrive at these savings figures, and there are those that perhaps would challenge them, but we do not think they are challengeable, and this kind of analysis would perhaps be useful to have in the record.

Chairman Proxmire. We would be delighted to have that and it will be printed in full in the record at this point.

(The detailed analyses referred to follow:)

Detailed Description of GAO's Estimate of Savings To Be Realized Through an Alternative Method of Financing—Section 235

Loans to purchase houses under the section 235 program are made by HUD-approved lending institutions and HUD insures that the mortgage will be paid. The purchaser is required to pay at least 20 percent of his adjusted income toward the monthly payment due under the mortgage for principal, interest, taxes, insurance and mortgage insurance premium. The balance of the required monthly payments are made by HUD. However, the payments by HUD cannot exceed the difference between the total monthly payment for principal, interest, and mortgage insurance premium and that amount which would be required for principal and interest if the mortgage bore interest at a rate of 1 percent. GAO considered an alternative method of financing the section 235 program to take advantage of the Government's ability to borrow funds at a lower interest rate than private parties. This alternative method of financing requires HUD to secure funds from the Treasury at the Treasury's cost of borrowing and make direct loans to low- and moderate-income families.

If the subsidized loans made under the section 235 program were financed with borrowings by the Treasury rather than by private lenders, the Government could take advantage of its ability to borrow funds at lower interest rates than those charged by private lenders. Data compiled by the Federal National Mortgage Association shows that the interest yield on home mortgage loans insured by HUD was 7.62 percent in August 1972. The interest yield on a recent issuance of long-term Treasury bonds ($2.3 billion, August 15, 1972) was 6.5 percent.

We used the present value method to estimate savings because we believe this is the most appropriate method of estimating long range costs. Under the present value method, the current values of fund flows over a specific period of time are calculated by use of a discount rate. The discounting of future costs makes them comparable to present costs; i.e., to the present value of costs. The 6.5 percent yield on a recent issuance of long-term Government bonds in August 1972 was used as the discount rate.

GAO estimated the total savings possible in fiscal years 1973–1990 if the section 235 program were financed by borrowings from the Treasury. The estimate is based on the following assumptions:

1. About 1 million (newly constructed and substantially rehabilitated) houses will be subsidized (through the section 235 program) in fiscal years 1973–78 as estimated in the President's second annual report on national housing goals. (An unestimated number of existing homes will also be financed through the section 235 program. No savings were estimated for these houses.)
2. The unit sales price of these houses will be as estimated in the President's second annual report on national housing goals in computing costs under the subsidy method of financing.
3. All purchasers of section 235 houses in the fiscal years 1973–78 period will receive mortgage subsidies for at least 13 years, the minimum subsidy period estimated by HUD in hearings before a subcommittee of the Committee on Appropriations, House of Representatives, 92nd Congress, Department of Housing and Urban Development, pages 246–250.
4. Government loans would be made at a 7 percent interest rate for 30 years. These loans will be prepaid in 15 years (the same prepayment period used by FNMA in arriving at interest yields on HUD insured home mortgages).
5. All purchasers of section 235 houses will receive the maximum subsidy during the first year of purchase and for each year thereafter, the subsidy will decrease by one-thirteenth.
6. Foreclosures would be substantially the same under either method of financing and therefore would not affect savings estimate.
7. Federal income tax recoveries will be at the rate of 4.5 percent. Assumptions made in arriving at the 4.5 tax recovery rate were:
   - A. Lenders' net income will be 8 percent of gross income.
   - B. Lenders will pay taxes at the corporate rate of 48 percent of their net income.
   - C. Lenders will pay out 40 percent of their net income after taxes as dividends.
   - D. Stockholders receiving dividends from lenders will have an average income tax rate of 30 percent.
8. The number of section 235 mortgages processed through the "tamdem plan" will be at the same rate which had been processed through December 1971, or 20 percent. Also, the cost of processing the mortgages through the tandem plan will

be at the rates GNMA bought and sold the mortgages in December 1971, which were 97 percent and 95.5 percent respectively.

As a part of our review we considered whether it would be necessary for HUD to perform mortgage servicing currently performed by private lenders if HUD were authorized to make direct loans on the 235 program. We believe that most private lenders who are currently involved in the section 235 program would be willing to continue to perform mortgage servicing even though loan funds were provided by HUD. Our review indicates that when the original lender sells the mortgage to FNMA, but continues to perform the servicing functions, FNMA is required to pay an annual fee of .375 percent of the unpaid principal balance for these services. Thus, we believe HUD would have to pay .375 percent for mortgage servicing.

The following is a brief general description of the approach taken in calculating the savings estimate. A more detailed description, explaining each of the computer program steps, is also available.

We at first estimated the present value cost of financing the section 235 program under the subsidy method. Estimates of the sales price and number of section 235 houses to be sold in fiscal years 1973–78 were taken from the second annual report on national housing goals, 91st Congress, 2nd session, House Document 92–292, table C, page 66. These estimates were used to calculate the total mortgage amounts for all section 235 properties for each of the fiscal years 1973–78 as shown in table I.

TABLE I.—VALUE OF SECTION 235 PROPERTIES TO BE SOLD

[Dollar in thousands]

Fiscal year	Unit price	Units to be produced	Total mortgage amount (column 2 times column 3)
1973	$17, 640	174, 980	$3, 086, 647
1974	18, 080	174, 966	3, 163, 385
1975	18, 530	174, 980	3, 242, 379
1976	18, 990	175, 045	3, 324, 104
1977	19, 460	174, 933	3, 404, 196
1978	19, 950	173, 964	3, 470, 581
Total		1, 048, 868	19, 691, 292

Using the prescribed formula for determining subsidy payments we calculated the maximum subsidy HUD would pay in the first year of the mortgage for each $1,000 of mortgage insurance written (annual subsidy of $46.26 per thousand dollars of mortgage insurance written). Using this amount, which was reduced by equal amounts over the 13 year period, and the mortgage amounts shown in table I we calculated the stream of monthly subsidy payments HUD would make to mortgagees during the period 1973 through 1990, and determined the present value of this stream of payments. The government borrowing rate of 6.50 percent was used as the discount factor to calculate the present value of the subsidy payments.

To estimate Federal income tax recoveries, we calculated what the mortgagees' total interest earnings would be for the mortgage amounts shown in table I through the use of outstanding principal balance factors shown in a HUD publication entitled "Amortization, Loss, Premium and Outstanding Premium Balance Tables, Part III." These amounts were multipled by a 7 percent interest rate and the resultant interest earnings were multiplied by a tax recovery rate of 4.5 percent. The tax recoveries were discounted at 6.50 percent to determine their present value. The present value cost of the subsidy payments are reduced by the present value of the Federal income tax recoveries.

To arrive at the cost of the tandem plan we multiplied each of the mortgage amounts in table I by 20 percent which gave us the estimated dollar amount of mortgages to be processed through the tandem plan. We multiplied this amount by 1.5 percent, the difference between the rate GNMA buys the mortgages (97 percent) and the rate it sells the mortgages (95.5 percent), and then determine the present value of this cost. After considering tax recoveries at a 4.5 percent rate, the tandem plan cost was added to the cost of the subsidy payments.

In computing the present value costs of the direct loan method of financing the section 235 program, we utilized the mortgage amounts shown in table I. The present value of the mortgage payments received from purchases under a government direct loan program was determined as follows:

1. We first calculated what the present value of mortgage payments would be on a 7 percent loan if there were no subsidy provided.

2. We then calculated the present value of the subsidy to be provided under a direct loan program. This calculation was the same as that described above for use in determining the present value cost of the subsidy method (see p. 4).

3. The present value of the mortgage payments received from purchasers was then calculated by taking the difference between 1 and 2 above.

Tax recoveries were calculated as explained on page 5. The lenders would be earning interest at a 6.50 percent rate under a direct loan program rather than at a 7 percent rate under the subsidy method. The tax recoveries on their earnings would reduce the cost of the direct loan program.

Also, as previously mentioned on page 4 we assumed that the private lenders involved in the financing the section 235 program under the subsidy method would continue to service the loans under a direct loan program for a service fee of .375 percent of the unpaid principal balance of the loan. To calculate this cost, we multiplied the loan amount by the outstanding principal balance factor for the prepayment period of 15 years, multiplied the result by .375 percent, and determined the present value of the servicing costs. After considering tax recoveries at a 4.5 percent rate, we added the net present value cost of servicing the loans to the other costs to determine the total costs of the direct loan method of financing the section 235 program.

The total present value cost of the direct method ($2,969,218,000) was then subtracted from the total present value cost of the subsidy method ($3,943,221,000) to arrive at an estimated savings of $974,003,000.

Detailed Description of GAO's Estimate of Savings To Be Realized Through an Alternative Method of Financing—Section 236

Multifamily loans under the section 236 program are made by HUD-approved lending institutions and HUD insures that the mortgage will be paid. Under the present method of financing the section 236 program, project owners obtain loans for the construction or rehabilitation of housing from HUD-approved lending institutions at interest rates established by HUD (currently 7 percent). HUD insures the loans and pays, on behalf of project owners, all interest in excess of 1 percent on the loans and the loan insurance premiums. Therefore, the cost of the section 236 program is dependent on the mortgage interest rate. If the mortgage interest rate could be reduced, HUD subsidy payments and therefore the cost of the section 236 program could also be reduced. With this in mind, GAO considered an alternative method of financing the section 236 program.

This alternative method of financing requires HUD to secure funds from the Treasury at the Treasury's cost of borrowing. If the subsidized loans made under the section 236 program were financed with borrowings by the Treasury rather than by private lenders, the Government could take advantage of its ability to borrow funds at lower interest rates than those charged by private lenders. Data compiled by the Federal National Mortgage Association shows that the interest yield on multifamily mortgage loans insured by HUD was 7.62 percent in August 1972. The interest yield on a recent issuance of long-term Treasury bonds ($2.3 million, August 15, 1972 was 6.5 percent).

As part of our review we considered whether it would be necessary for HUD to perform mortgage servicing currently performed by private lenders if HUD were authorized to make direct loans on the 236 program. We believe that most private lenders who are currently involved in the section 236 program would be willing to continue to perform mortgage servicing even though loan funds were provided by HUD.

GAO estimated the total savings possible in fiscal years 1973–1997 if the section 236 program were financed by borrowings from the treasury. The estimate is based on the following assumptions:

1. About 1 million (newly constructed and/or rehabilitated) rental units will be subsidized (through the section 236 program) in fiscal years 1973–78 as estimated in the President's second annual report on national housing goals.

2. The value of section 236 units to be rented will be as estimated in the President's second annual report on national housing goals.

3. Section 236 mortgagors will receive interest subsidies for at least 20 years, the minimum subsidy period estimated by HUD in hearings before a subcommittee of the Committee on Appropriations, House of Representatives, 92nd Congress, Department of Housing and Urban Development, pages 246–250.

4. Government loans would be made at a 7 percent interest rate for 40 years. These loans will be prepaid in 20 years.

5. Project mortgagors will receive the maximum subsidy during the first year of purchase and for each year thereafter, the subsidy will decrease by one-twentieth.

6. Foreclosures would be substantially the same under either method of financing and therefore would not affect savings estimate.

7. Federal income tax recoveries will be at the rate of 4.5 percent. Assumptions made in arriving at the 4.5 tax recovery rate were:

A. Lenders' net income will be 8 percent of gross income.

B. Lenders will pay taxes at the corporate rate of 48 percent of their net income.

C. Lenders will pay out 40 percent of their net income after taxes as dividends.

D. Stockholders receiving dividends from lenders will have an average income tax rate of 30 percent.

8. The number of section 236 mortgages processed through the "tandem plan" will be at the same rate which had been processed through December 1971, or 20 percent. Also, the cost of processing the mortgages through the tandem plan will be at the rates GNMA bought and sold the mortgages in December 1971, which were 100 percent and 96.75 percent respectively.

9. Sixty-percent of loans are made to profit-motivated entities and 40 percent to nonprofit entities (HUD has estimated that this ratio will occur over the life of the section 236 program).

The following is a brief general description of the approach taken in calculating the savings estimate. A more detailed description, explaining each of the computer program steps, is also available.

We at first estimated the present value cost of financing the section 236 program under the subsidy method. Estimates of the value and number of units to be rented in fiscal years 1973–78 were taken from the second annual report on national housing goals, 91st Congress, 2nd session, House Document 92–292, Table C–2, page 66. These estimates were used to calculate the total mortgage amounts applicable to section 236 projects for each of the fiscal years 1973–78 as shown in Table I.

TABLE I.—VALUE OF SECTION 236 UNITS TO BE RENTED

[Dollars in thousands]

Fiscal year	Unit price	Units to be produced	Total mortgage amount (column 2 times column 3)
1973	$19,330	165,000	$3,189,450
1974	19,810	175,006	3,466,869
1975	20,310	175,033	3,554,920
1976	20,820	174,995	3,643,396
1977	21,340	174,993	3,734,351
1978	21,870	171,989	3,761,399
Total		1,037,016	21,350,385

To account for a 10 percent net equity investment that profit-motivated owners are required to invest in a section 236 project, we adjusted the total mortgage amounts in table I. Our calculation of the adjustment was made under the assumption that 60 percent of section 236 project owners are profit-motivated entities and 40 percent are nonprofit institutions. The total mortgage amounts for fiscal years 1973–78 were adjusted as shown in table II.

TABLE II.—VALUE OF SECTION 236 UNITS TO BE RENTED (ADJUSTED TO ACCOUNT FOR 10 PERCENT INVESTMENT BY PROFIT-MOTIVATED SPONSORS)

[In thousands of dollars]

Fiscal year	(1) Total mortgage amount (from table I)	(2) 60 percent of (1)	(3) 10 percent of (2)	(4) Adjusted total mortgage amount (1) minus (3)
1973	$3,189,450	$1,913,670	$191,367	$2,998,083
1974	3,466,869	2,080,121	208,012	3,258,857
1975	3,554,920	2,132,952	213,295	3,341,625
1976	3,643,396	2,186,038	228,604	3,424,792
1977	3,734,351	2,240,611	224,061	3,510,290
1978	3,761,399	2,256,839	225,685	3,535,714
Total	21,350,385	12,810,231	1,281,024	20,069,361

Using the prescribed formula for determining subsidy payments we calculated the maximum subsidy HUD would pay in the first year of the mortgage for each $1,000 of mortgage insurance written (annual subsidy of $49.20 per thousand dollars of mortgage insurance written). Using this amount, which was reduced by equal amounts over the 20 year period, and the mortgage amounts shown in table II we calculated the stream of monthly subsidy payments HUD would make to mortgagees during the period 1973 through 1997, and determined the present value of this stream of payments. The government borrowing rate of 6.50 percent was used as the discount factor to calculate the present value of the subsidy payments.

To estimate Federal income tax recoveries, we calculated what the mortgagees' total interest earnings would be for the mortgage amounts shown in table II through the use of outstanding principal balance factors shown in a HUD publication titled "amortization, loss, premium and outstanding premium balance tables," part III. These amounts were multiplied by a 7 percent interest rate and the resultant interest earnings were multiplied by a tax recovery rate of 4.5 percent. The tax recoveries were discounted at 6.50 percent to determine their present value. The present value cost of the subsidy payments are reduced by the present value of the Federal income tax recoveries.

To arrive at the cost of the tandem plan we multiplied each of the mortgage amounts in table II by 20 percent which gave us the estimated dollar amount of mortgages processed through the tandem plan. We multiplied this amount by 3.25 percent, the difference between the rate GNMA buys the mortgages (100 percent) and the rate it sells the mortgages (96.75 percent), and then determine the present value of this cost. After considering tax recoveries at a 4.5 percent rate, the tandem plan cost was added to the cost of the subsidy payments.

The present value of the mortgage payments received from project owners under a government direct loan program was determined as follows:

1. We first calculated what the present value of mortgage payments would be on a 7 percent loan if there were no subsidy provided.

2. We then calculated the present value of the subsidy to be provided under a direct loan program. This calculation was the same as that described above for use in determining the present value cost of the subsidy method.

3. The present value of the mortgage payments received from purchasers was then calculated by taking the difference between 1 and 2 above.

Tax recoveries were calculated as explained on page 6. The lenders would be earning interest at a 6.50 percent rate under a direct loan program rather than at a 7 percent rate under the subsidy method. The tax recoveries would reduce the cost of the direct loan program.

Also, as previously mentioned on page 2 we assumed that the private lenders involved in financing the section 236 program under the subsidy method would continue to service the loans under a direct loan program for a service fee of .375 percent of the unpaid principal balance of the loan. To calculate this cost, we multiplied the loan amount by the average outstanding principal balance fac-

tor for the prepayment period of 20 years, multiplied the result by .375 percent, and determined the present value of the servicing costs. After considering tax recoveries at a 4.5 percent rate, we added the net present value cost of servicing the loans to the other costs to determine the total costs of the direct loan method of financing the section 236 program.

The total present value cost of the direct loan method ($4,575,017,000) was then subtracted from the total present value cost of the subsidy method ($5,785,061,000) to arrive at an estimated savings of $1,210,044,000.

Chairman PROXMIRE. My time is just about up and I would like to ask a couple of questions here.

Is it any more inflationary to finance 235 and 236 housing through direct Federal loans?

Mr. STAATS. Any more inflationary? No; I do not see it.

Chairman PROXMIRE. It would not have any effect.

In view of the substantially higher defect rate in existing 235 housing as compared to new housing, would you recommend that Congress restrict or eliminate the availability of 235 funds for existing housing?

Mr. STAATS. I do not have any feeling on that unless Mr. Birkle and Mr. Eschwege have something to say.

Mr. BIRKLE. No; I would not recommend that at this time. I think through proper management in HUD, improvements can be made in the program to make it work. So I do not think that is really needed. HUD had a moratorium on insuring existing 235 housing for awhile, while they got some things straightened out in response to Congressman Patman's hearings about a year and a half ago, but I do not think that you need to do away with 235 on existing housing.

Chairman PROXMIRE. OK. I have other questions which I will come back to.

Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

Mr. Staats, I apologize for not having heard your entire oral statement. I wonder if you could summarize telling me approximately how many housing units we are talking about here. We have housing construction rates of anywhere between 2 and 2½ million units a year, depending on the month of the year. How many of these are Government-sponsored one way or another through the subsidy program and direct public housing?

Mr. STAATS. Are you referring now, Congressman Conable, only to the 235 and 236 programs?

Representative CONABLE. I am talking about total.

Mr. STAATS. Total, we are running about 2.3 million, this year.

Representative CONABLE. Yes; on the average, I would say it is probably about that.

Mr. STAATS. I do not have that figure at my fingertips.

Mr. BIRKLE. Well, there have been 330,000 section——

Representative CONABLE. I cannot hear you, sir.

Mr. BIRKLE. 330,000 section 235 mortgages through June 30, 1972.

Representative CONABLE. You mean that is the total or is that the number in 1972, just the first 6 months?

Mr. ROHRER. I think there are about 600,000 subsidized a year.

Representative CONABLE. A year?

Mr. ROHRER. That is all subsidized programs.

Representative CONABLE. All subsidized programs.

Mr. ROHRER. Yes.

Representative CONABLE. Is that the great bulk of the public housing?

Mr. ROHRER. That includes public housing.

Representative CONABLE. So you are talking about roughly a quarter of the total housing needs that are being met by public programs in the country on an annual basis now; is that correct?

Mr. ROHRER. Yes.

Representative CONABLE. When you check for housing defects, and you have some dramatic evidence of these here, do you have any standard in the private sector against which these could be checked? Is this sort of thing happening in private housing also? I am somewhat bemused by the relationship between the Government and the individual who moves into this housing. Has the Government become a guarantor of the housing? Does the individual have any responsibility himself? Anybody looking at these pictures would know that was a defective house. Yet, I assume the typical homeowner who moves into such property is so anxious to get in that he accepts the defects and that in effect he becomes a kind of an irrelevance to the process and is relying on Government protection rather than on the judgment of his own senses which would tell him that is defective housing. What is the relationship here, as it works out?

Mr. STAATS. Well, I would like to start out and then ask my colleagues here to elaborate. Some of these defects would have been obvious, as you say, at the time the family moved into that house. Others would have showed up sometime later. We are dealing here with generally low income, unsophisticated people who either would feel that the Government was going to protect them against any defects that would show up in that property or might have been existing at the time they moved into it, or may have been so in need of housing that they would take it anyway. I think that is about as good an answer as I could give you. Whereas a person in a better situation, already, perhaps well housed, would be a much more stringent examiner of the quality of the house before he would ever accept title to it, as I think you and I would.

The same question you have raised is a question I raised with my staff. These are such obvious defects that someone should have noticed this somewhere very early.

Now, we have had a homeownership policy to correct defects in existing housing only since January of 1970, I believe. So that prior to that time there was no protection of that type available. Now he has a protection for a 12-month period and that is the reason we suggest here there ought to be some positive inspection within, say, the first 11 months so as to be able to make that homeownership policy of some value to the property owner. Is there anything more you would want to add to that?

Mr. BIRKLE. Well, the type or the group of people that you are dealing with in subsidized housing programs have never owned a home before. Many of them or most of them, are not aware of the type of defects they might run into, and when they see defects they do not necessarily realize their significance; so this is part of the problem. In order to make the program work you are going to have to deal with these people in a different manner than you deal with the people in your regular unsubsidized FHA programs.

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Representative CONABLE. Another figure that may be available in your charts I do not have, what is the total amount of the Government guarantee on housing at this point? We are dealing with a contingent liability in effect—it is not part of the national debt. We have talked about how you could save a lot of money by direct financing instead of having private financing with Government guarantee. How much are we talking about? What do we add to the national debt if this were included as a direct liability instead of a guarantee? You talked about the saving that would be involved here but what are we talking about in terms of the total addition?

Mr. ROHRER. For the program 1973 through 1978 it would be about $20 billion in loans for each of the two programs.

Representative CONABLE. Do you have any idea what the total amount of the Government contingent liabilities is right now?

Mr. ROHRER. For subsidized housing?

Representative CONABLE. For all purposes.

Mr. ROHRER. For all purposes it is over $85 billion.

Representative CONABLE. Over $85 billion, that is in effect part of the national debt but not included.

Well, one other line of inquiry. You mentioned the fact that the incentives are to build and not to manage. I suspect it is construction people who go into this work and are looking for the quick buck and not for the 6 percent return, the long run return that you described as being perhaps an inadequate incentive. I wonder if you have made any study of the tax laws with respect to private multiple housing, too. Is it not true that there we give incentive entirely to construction through the double declining balance

Mr. STAATS. You are referring here of course, to the rental project housing, section 236?

Representative CONABLE. Yes.

Mr. STAATS. We have not made any analysis of this ourselves. We are inclined to think it would be useful if, say, HUD, working with the Treasury Department, could undertake a review of the type that you are suggesting. We believe that the competence to make this kind of analysis would be in those two agencies, and frankly, we would encourage any studies of this type which could be undertaken.

Representative CONABLE. I think you will find we put the incentive on construction of such housing and not the management of such housing.

Mr. STAATS. That is right.

Representative CONABLE. Even in the private sector where we do have a tax haven for investments in multiple housing.

Mr. STAATS. The double declining balance depreciation policy written into the tax law means that after the 10th year, when you shift over to the straight line depreciation, the incentive is pretty well gone to manage that property economically.

Representative CONABLE. It seems as though we made the invitation to substandard housing across the board pretty much by putting all the emphasis on quick money to be made in construction rather than on the long term money to be made from management. Would that square with your investigation?

Mr. STAATS. That is right. It also compounds the problem which we have indicated here where they have been so anxious to rush in and get large numbers under construction that they have not done as good a job of analyzing where the real need exists around the country for the housing.

Representative CONABLE. Of course, the question is, if we do not have this kind of incentive for construction, are we going to be able to meet the housing goals that we have set in the Housing Act, the 2.6 million starts a year that were considered over a 10-year period following the enactment of that national housing goal? It is one of the dilemmas we face, I guess.

Mr. STAATS. It is a dilemma but, of course, the basic issue which is involved here is whether we might not be better off to proceed a little bit more cautiously, more slowly.

Representative CONABLE. And get better housing?

Mr. STAATS. Get better housin gat lower cost.

Representative CONABLE. Yes; I think this is a very interesting study, sir. Thank you very much.

Chairman PROXMIRE. Congressman Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman.

Thank you, Mr. Staats, for a very fine statement. Let me preface my questions with this observation. I have been one of the most vocal critics of the 235 and 236 programs since their enactment, so what I say here is not from one who has defended the program. I have seen many problems that we have created in Congress, and I think the emphasis on production that you have referred to is a result of congressional mandate. It was Congress that said we must build 26 million houses over a 10-year period; and, of course, they illustrated to the Congress, that it would work, and proceeded to build 26 million starts over 10 years. But I took some exception to your observation that the Government could "save money by a direct loan." Are you failing to take into account the cost of administering those loans which are now being done by private mortgage bankers?

Mr. STAATS. We have included a factor, the same factor that is now allowed for administration, so we think we have met that point, and it is included in the analysis which the chairman has agreed that we put in the record.

Representative BLACKBURN. Well, do you not see some danger in possibly socializing the housing industry my making the Government that directly involved in the housing industry?

Mr. STAATS. I guess this is perhaps even a slightly philosophical question. The Government is the guarantor here; the Government has the contingent liability already, and the Government is subsidizing it. We are dealing with this as a Government matter because these are low-income groups that we are trying to provide housing for, and we are still dealing with perhaps a quarter or even less of the total volume of housing construction in the country. I would not, frankly, be too much concerned about this point. I think the main objective here is to get that housing, good quality housing at the lowest price and at the least cost to the Government.

Representative BLACKBURN. Let me ask you this. Would it not make more sense to require the lender to share in some of the loss? To me

one of the criticisms of this program has been that the Government has given a check to the lender and said in effect, "Whatever loss occurs we will bear." And to me, one of the reasons we would like to keep the private investor in this program is because his machinery, his own inspectors, his own evaluation, his own evaluators would have the responsibility to go out and look at this responsibility from time to time, to make sure that it is being maintained. Under our present operation the lender has no incentive to protect the houses to see that they are properly maintained. Is that not true?

Mr. Staats. That is part of our point here. As to whether this could be shared—so as to put greater incentive on the part of the builder to build quality housing at low price—is, I suppose, a judgment as to whether or not there would be enough takers who would be willing to assume that obligation.

I do not personally have a judgment on this, perhaps my colleagues here would have; but if it could be done, I would certainly agree with you it should be a move in the right direction.

Representative Blackburn. Well, the reason I do not want to see the Government get totally involved in the program is because the very problem you have pointed out are Government problems, Government administration problems. That is, it has been Government evaluators that have taken a piece of property that a private speculator has bought for, say, a thousand dollars an acre, and given him authority to borrow against that land on the basis that it is worth maybe $1,200 an acre or even $1,500 an acre. I know because I personally made a considerable investigation into this program, I am on the Housing Subcommittee in the House, I visited a number of cities and, frankly, some of the examples you have given do not really illustrate some of the true horrors in the program. We have seen some so-called mobile home examples where the buildings were coming apart at the seams, literally, and they were less thay two years old. The real horrors in the program are not really brought before us here today. So, as I say, I think we should keep the private lender in the market because he would be less likely than Government to just give the speculator a carte blanche if he knows he is going to have to share some of the losses if that loan goes bad. Do you share my view to some degree on that?

Mr. Staats. Well, I would agree that unless the Government were willing to provide the necessary administrative resources to do what we think needs to be done, that that would create a considerable difficulty in effectuating the recommendation which we have said we think should be considered. But certainly, I would not be against moving in the direction that you have outlined here provided that we could get enough lenders to take on that obligation.

Representative Blackburn. Well, now, I frankly have proposed in this committee several times, that we instruct the lender, the mortgage bankers in effect, to understand if this loan goes sour they are going to share in the loan to the extent of at least 20 percent. The argument comes back to me that if you do that you are going to kill the program. Well, if the programs are that weak and that poor then perhaps they ought to just run the risk that they will die if they cannot stand on any better footing than that because if all goes well we are committed

for over $100 billion, and if things really go bad we are committed for a great deal more than that. So, I think it is only fair that we, to some extent, make these programs stand on their own economic hind legs, so to speak.

Have there been any figures developed regarding the amount of equity that has been accumulated in the average 235 house when it has been foreclosed? Of course, we are in a dilemma if we demand more than the equity down payment; then the people cannot afford them. But we have provided them such a very low equity that in my own opinion they can pay on it 2 or 3 years. If they want to move out they will not even have enough equity to pay a real estate commission. Is that not one of the problems.

Mr. Birkle. That is correct, they have very low equity at the time they lose the houses. There is no reason for them to stick with it because of their investment. That is the point you make.

Representative Blackburn. That to me is one of the problems in the program. If a man lives there for, say, 3 or 4 years and he wants to move and, in the meantime there has been some deterioration in the house so he calls a real estate man up and the man comes out and looks at it. He says the resident must spend $500 on maintenance before we can get the house in condition to sell, and he says, gee, what have I got in it now and what is your commission and what would be the point if we had to refinance it? And so the cheapest thing for him to do is put his hat on and walk off. I have seen houses abandoned in less than 6 weeks that have been so vandalized they could not be repaired again.

Let us get back to the problem of existing housing. Have you looked into the cost of repairing some of the defects that existed at the time of purchase? I am talking about the section 518 program and the cost of those repairs as compared to the loss if foreclosure takes place.

Mr. Birkle. Well, when we did our work in Detroit for Chairman Monagan of the Subcommittee on Legal and Monetary Affairs, we did look into this aspect in that city. We found examples of houses where HUD was spending $10,000 and $12,000 to make repairs for defects that existed at the time that the insurance was written.

Now, those are maybe extreme cases. We do know in Detroit that the average loss on the properties that are being acquired amounts to around $9,000 to $10,000 per house. Now, I must say that in Detroit a very small percentage of the insurance is section 235. It is only around 7 or 8 percent, so you cannot——

Representative Blackburn. What is the balance of it?

Mr. Birkle. Most of it is section 221(d)(2), which is a low down payment program primarily on existing houses. If the sales price is low enough, low income buyers can purchase houses without the subsidies.

Representative Blackburn. Now, the 221(b)(2) program was in existence prior to the 235?

Mr. Birkle. It has been in existence for 11 years.

Representative Blackburn. We are not saying all of these problems have arisen under this administration, are we? Have not some of these sales and problems arisen under the previous administration? They are not all peculiar to Secretary Romney and his administration?

Mr. BIRKLE. Well, I guess that would be correct because the program started before his administration.

Representative BLACKBURN. Well, I just wanted to try to avoid too much partisanship in our presentation here today and the conclusions that might try to be resulting.

I have no further questions at this time, Mr. Chairman, and I appreciate you gentlemen making your appearance here today.

Chairman PROXMIRE. Can I ask you, Mr. Staats, how widespread are the housing repossession scandals? I do not see, on the basis of the record I have here, that they are confined to Detroit. They seem to be found quite extensively elsewhere, Los Angeles, Dallas, Philadelphia, Atlanta, and Chicago. In fact, Detroit has a lower percentage than many others in the 235 program.

Mr. STAATS. I believe that is correct, Mr. Chairman. Mr. Birkle, do you want to respond?

Mr. BIRKLE. That is true on 235, but looking at all single family home property repossessions around the country, Detroit has almost 20 percent of these repossessions. Seattle is next with about 10 percent. I think there are around 57,000 houses in HUD's inventory right now, and Detroit has over 11,000 of these houses.

Chairman PROXMIRE. But it is not confined to Detroit. Detroit has 20 percent and you have very high rates, as you have indicated, in other cities, too.

Mr. BIRKLE. Seattle, Los Angeles——

Chairman PROXMIRE. Dallas, Philadelphia, and Chicago.

Mr. BIRKLE. Right.

Chairman PROXMIRE. Now, Mr. Katz is going to testify a little later on that during his stewardship of the program in Milwaukee, there were very few defaults and repossessions. Does not this indicate that the primary reason for the high number of repossessions is the overwhelming failure in management by HUD rather than the intrinsic nature of the program?

Mr. BIRKLE. Well, the fact that it has been more successful in Milwaukee would indicate that to be true. We have never made a detailed study of Milwaukee. We do know that they emphasized quality to a much greater extent.

Chairman PROXMIRE. The fact that you have this terrific variation, would you say from 2 percent to 20 percent, something like that, or is that——

Mr. BIRKLE. The sample we have in our report shows a 2 to 20 percent variation.

Chairman PROXMIRE. It is the same program, so it would seem to me it is a matter of abysmal failure of management in some areas.

Mr. BIRKLE. This would be true.

Mr. STAATS. You also have to keep in mind, though, I think, Mr. Chairman, that there is another variable here, which you have already alluded to, and that is the economic conditions in a given area at a particular point of time, which are bound to have an important bearing here.

Representative CONABLE. What about tolerance of default, too? We have had repossessions in some cases but may that not mean that the Government is moving more promptly in these areas of default than

in other areas where we may have very substantial mortgage arrearages, and so forth?

Mr. BIRKLE. This is possible. The laws on foreclosure vary from State to State.

Representative CONABLE. Yes, they do a great deal.

Mr. BIRKLE. Sometimes it takes longer to foreclose in one place as compared with another.

Chairman PROXMIRE. Now, is this not all give and take, especially Mr. Conable's good point emphasizing it is really HUD's responsibility to go into these matters and give us some basis for judgment as to the reasons for this? But they failed to do it. They still have not given us any analysis of why it is higher in one place than another. It may well be as Mr. Conable says, that the place where the scandals have emerged is because of the tolerance factor. Should not HUD give us this data? Should they not find out, should they not study it, the analysis of the default reasons?

Mr. STAATS. Where there are these variable situations from area to area, certainly they are in the best position to do that. When I was referring to the economic conditions, Mr. Chairman, we were thinking particularly of Seattle. Seattle, as you know, has had a pretty serious unemployment situation and you can see a pretty close correlation between the unemployment levels there and the default rate.

Chairman PROXMIRE. Would you say the major reason for the scandals was due to the decentralization of the program and appointment of inexperienced personnel or appointment for personal or political reasons to head these decentralized offices? Is that a factor, Mr. Birkle?

Mr. BIRKLE. No, I do not think so, Mr. Chairman. The groundwork for the scandals, if you want to call them that, was taking place before the reorganization, decentralization occurred. The increase in production, in 1969 and 1970, is when most of the insurance was being written where HUD is now acquiring the property.

Chairman PROXMIRE. If that is not the situation, how about the appointment of people who are on these programs?

Mr. BIRKLE. We have not made any analysis of this.

Chairman PROXMIRE. You do not know whether it could, but in view of your previous response to the Milwaukee experience, I presume this is an element.

In connection with section 236 multi-family or rental subsidies, HUD methods of land appraisal have apparently permitted rather high profits to be made. Rather than using the acquired cost of the land as a measure of its value, HUD has determined the value of proposed project sites by measuring it against five comparable sites which have been recently sold or offered for sale in the nearby area. While that might appear to be fair, your analysis shows that in 47 of 68 projects examined, HUD appraised the value of the land significantly above cost; and 12 of these projects had appraisals 25 percent above cost.

In an amazing case in Dallas, you found a son-in-law who purchased some land for $149,000, offered it to his father-in-law for $311,500 on the same day, and then the father-in-law offered it to HUD and obtained approval for a section 236 rental project with the land valued at $311,500. When the HUD appraiser was questioned on this particular project he reappraised it and came up with the same amount.

At first your studies find that such activities have resulted in higher interest subsidy cost to the Government and higher rent to project tenants, estimating that for 12 projects the subsidy cost alone would increase by $2 million over the lifetime of the 12 mortgage loans. Can you give us some estimate of how much this kind of land cost escalation will increase the subsidy cost to the Government for all 236 rental subsidies?

Mr. STAATS. It is quite obvious it would increase them, Mr. Chairman. You are quite correct in that statement. We have not gone through on a case-by-case basis and made the analysis. That is about the only way we would know how to do it. There are about 2,500 cases involved here, so it really would mean going through those and making the analysis on a case-by-case basis. For that reason I do not think we can give you a total. I suppose this could be done but it would be a very extensive——

Chairman PROXMIRE. I would rely on your judgment on that. If you think it is worthwhile we would like to have it.

Mr. STAATS. It would be a very substantial undertaking.

Chairman PROXMIRE. Take a look at it and see if you can do it.

Mr. STAATS. If it can be done with a reasonable amount of effort we will do it, but we have not really analyzed it.

Chairman PROXMIRE. Are land appraisal problems widespread or is the Dallas case an exception, in your view?

Mr. STAATS. Well, I do not think it is an exception by any means. Mr. Birkle can perhaps answer your question more fully; but that is a fairly extreme case. We do have some analyses of this type.

Mr. BIRKLE. Well, we found in 12 out of 68 that the land appraisal was a problem, where it was more than 25 percent above a recent purchase price by the owner or an option price. So it's 12 out of 68, so, if you want to strike a percentage, you could.

Chairman PROXMIRE. About 20 percent.

Mr. STAATS. Here is one in Atlanta, for example, it was 3 months between the purchase or option agreement and the HUD evaluation where it was appraised at 256 percent of cost. One after 17 months was 333 percent of cost, another one was 132 percent after 2 months. A somewhat similar picture in the Dallas region and a somewhat similar picture in the Los Angeles region, shows it is not an isolated matter at all.

Chairman PROXMIRE. Your reports indicate, Mr. Staats, you had discussed land appraisal procedures with numerous realtors and that many advised you that the use of cost data was generally an excellent measure of fair value. Why cannot HUD devise some appraisal method which is more closely related to acquired cost of properties?

Mr. BIRKLE. Well, recently HUD issued guidelines, in April of 1972, which do now stress giving greater emphasis to the prices that owners had paid for project land, and the guidelines require justification of any substantial difference between the appraised amount and the amount paid in a recent purchase made by the owner for the land. So, they are taking this step. Now, you know, whether or not, it succeeds in lowering the prices remains to be seen.

Chairman PROXMIRE. Do you know whether that has been effective or not?

Mr. BIRKLE. Well, the guideline went out in April of 1972 and I assume it is being implemented or followed in the field, although we have not gone back to check to see if it has.

Chairman PROXMIRE. Is it not correct that your studies also show in the Dallas area 16 profit-motivated 236 rental projects had total legal and organizational fees of $450,000, whereas the fees indicated for these projects by HUD guidelines would have been $248,000, a difference of about $203,000, or almost a 100-percent cost overrun?

I am very concerned about such waste and would like to know precisely where HUD management broke down and allowed these big increases over their guidelines. What would you advise the Congress to do about this management deficiency, sir?

Mr. STAATS. We understand, in this case, HUD is going back and looking into it as a special case, but whether it is an isolated example, I do not know.

Mr. BIRKLE. I think HUD was surprised to find this out, to have that finding called to their attention in the Dallas area. It may be peculiar only to that area.

Chairman PROXMIRE. Let me get very quickly into mortgage default. Your prepared statement reports that mortgage defaults could become a major problem for the section 235 homeownership program. In fact, you indicate that at an average loss of about $3,835 to manage and dispose of each defaulted property, HUD could eventually incur losses of about $532 million on 235 homes insured through fiscal year 1978. This, of course, is even more serious than the problem of deficient quality, and I would like to ask a number of questions about it.

There is the widespread notion in the press and the public at large that major defaults in Government-sponsored housing has been associated with subsidized housing, such as the 235 homeownership program. Your findings do not seem to confirm this. Appendix III of your prepared statement, for example, shows that in nonsubsidized homeownership programs aimed at serving low income families, such as section 221(d)(2), the problem of defaults is more acute.

Mr. STAATS. That is correct. So far, the 221(d)(2) program has had a higher rate than the 235 program.

Chairman PROXMIRE. Do you have data which would give us some idea about the incidence of default among new and existing homeownership programs, both subsidized and nonsubsidized?

Mr. BIRKLE. No; we do not have any breakdown on that.

Chairman PROXMIRE. Your prepared statement indicates your default rates varied from a low of about 2.2 percent in one HUD office to a high of 20 percent in another. Why the incredible variation? I guess we have been through that, to some extent.

Mr. BIRKLE. Yes.

Chairman PROXMIRE. And you think it is management and also, perhaps as Mr. Conable suggests, the lack of applying guidelines in the same way, and also a lack of tolerance in some cases or too much tolerance in others?

Mr. STAATS. Plus the economic conditions that may affect one locality more than others.

Chairman PROXMIRE. Let me ask a question that has bothered me a great deal. This is something that I think has bothered the public a

lot. You give in your prepared statement a series of the advantages that are given the people to invest in housing, to encourage it. You say incentives to invest in federally subsidized multifamily housing have been provided in the form of tax shelters that may be used to reduce Federal income tax liabilities. Some of the tax incentives include accelerated depreciation, more liberal provisions for the recapture of accelerated depreciation in event of sale, 5-year writeoff rehabilitation costs, deferment of taxable gain when it is reinvested in other subsidized housing, and allowance of a fair market value rather than depreciated cost as a deductible item when housing is donated to qualified charitable organizations.

Have you made any attempt, Mr. Staats, to determine what the cost of the various tax incentive programs in housing are, how effective they have been, and how they would compare with alternative methods of encouraging housing? Somewhere, it seems to me, I have read that the overwhelming amount of subsidy is in the tax incentive area. We concentrate most of our attention, of course, in the direct subsidy area. But the tax incentive area is the one that is most costly to the taxpayer who cannot take advantage of it.

Mr. Staats. Without having made a detailed overall analysis, I would be reasonably comfortable in judgment——

Chairman Proxmire. What is that?

Mr. Staats. Without having made a complete analysis of it, I would be fairly comfortable in agreeing with you that this is the area of the greatest amount of subsidy. But to answer your question specifically, we have not attempted to make an overall analysis of all of the elements of subsidy in the total housing program, to break them down by elements. It would be a very difficult job to do.

Chairman Proxmire. All you find, then, in analyzing 236 is that it does not encourage people to manage effectively after 10 years.

Mr. Staats. We are very certain about that.

Chairman Proxmire. How much of a task would it be to determine the cost of the incentives?

Mr. Staats. If you just take that one program——

Chairman Proxmire. And the effectiveness.

Mr. Staats (continuing). I think this could be done. We have not really discussed this within the office but I would be reasonably certain this could be analyzed. It would be a matter of taking them on a case-by-case basis again, however.

Mr. Eschwege.

Mr. Eschwege. Well, as you know, these tax incentives affect different taxpayers in a different way, corporations differently than individuals. It also has a lot to do with questions such as: if you do have a loss, can you apply it against some other income that you have? So you have these individual problems of the taxpayers, which may be difficult to assess. I do think, however, that the Treasury Department might be able to assist in this area; they are more knowledgeable than we are in this particular area.

Chairman Proxmire. What Department?

Mr. Eschwege. The Treasury Department, specifically the Internal Revenue Service.

Mr. Staats. You would have to make your analysis either on an average rate or you would have to go alternatively to each individual taxpayer's record to find out the extent to which a subsidy did or did not help him in his tax situation.

Chairman Proxmire. I just have one other question. My time is up, and I would like to ask that question, and ask you to summarize, and then I will yield to my colleagues, with their permission.

A recent study of the GAO called "Enforcement of Housing Code: How It Can Help To Achieve Nation's Housing Goals," finds that housing decay has not been halted because (1) communities have not enforced housing codes, and (2) HUD has not used its legislative authority to stop funds for Federal housing programs until code reform is achieved.

Just how poor has HUD's record been in this area? What do you recommend?

Mr. Staats. Mr. Birkle, do you want to answer that?

Mr. Birkle. Well, here again, in our report on enforcement of housing codes we brought out the fact that HUD had emphasized housing production at the expense of not assuring that the existing stock of housing was being maintained properly. In our report, we made several recommendations for more effective local code enforcement; better monitoring and policing of that local effort on the part of local governments and on the part of HUD; and less emphasis being placed on public improvements, such as in Detroit, where we found they were spending $800,000 on paving alleys and at the same time the houses that were involved in those particular neighborhoods had serious code defects. The money could have been better spent to help those people rehabilitate and make improvements to their homes.

Mr. Staats. We feel very strongly about this issue, Mr. Chairman, and we were frankly disappointed that our report has not received more attention than it has, because you are getting to the very basic issue here and it is not all the Federal Government's fault by any means. A lot of this goes to the localities themselves. There is not a whole lot of point in the Federal Government assisting in subsidized housing and then finding that no one—I say no one, maybe that is too strong—gives adequate attention to enforcing the housing codes that are already in existence.

Chairman Proxmire. Maybe that ought to be one of the conditions of providing Federal assistance.

Mr. Staats. We think something of this type is very badly needed.

Chairman Proxmire. Then let me conclude my questioning of you, Mr. Staats, by asking you this. You seem to suggest on the basis of analysis that you do not indict or if you do indict, I would like to know that my conclusions are correct the intricate nature of the housing subsidy programs, 235, 236, 502 and so forth, but that you do criticize the management of these programs, and your conclusion is they have been badly managed and that by better management we could save a great deal of money plus the fundamental changes which you suggest, including direct Government loans and one or two other things; is that correct?

Mr. Staats. Plus the other point of providing some management incentives to owners under 236——

Chairman PROXMIRE. Right.

Mr. STAATS (continuing). Beyond the 10-year period where the incentives are already built into the tax laws.

Chairman PROXMIRE. Thank you.

Mr. Conable?

Representative CONABLE. I have only one question. In your prepared statement you state that agriculture has stated also that the States will be instructed to channel at least 50 percent of the allocation of rural housing section 502 funds into housing for low-income families.

Is there some basis in law for this allocation or is it just a political decision? Why was it not 30 percent or 70 percent or some other figure than 50 percent?

Mr. STAATS. There is no statutory basis for it that I am aware of. I think it was an administrative decision taken by the department.

Representative CONABLE. In effect, they feel that would result in an appropriate allocation of money.

Mr. STAATS. It had to be somewhat arbitrary because they really had not made a detailed analysis on needs. This is what we are somewhat critical about when they granted it. They wanted to get the program underway and this is a very arbitrary kind of a split.

Representative CONABLE. One other question. In your opinion, if we did not have substantial incentives for the building of multiple housing are we going to be able to attract the money into this field? You know why local housing codes are not enforced; because the poor people themselves do not want them enforced. They do not want to get put out on the street and that is their concern. We have a dilemma where they say, "Look, I do not care if there are water stains on the ceiling as long as I have got a place to live," and it is one of those basic problems.

Mr. STAATS. It is a dilemma, there is no question about it, and to require a residence to be brought up to the code almost certainly involves somebody's having to spend some money. But these things are interrelated in the sense that if you do not build a house properly in the first place then you have got a code problem right from the very beginning. I do not see how you can disassociate the two problems.

Representative CONABLE. Yes.

Mr. STAATS. I agree with you. There is no way, that I am aware of, that you can provide housing for the income groups that we are trying to provide better housing for without some degree of subsidy. It is a question of how you can best apply that subsidy and how you can best create incentives in the private enterprise system to build this housing in the best possible manner.

Representative CONABLE. It is one of those dilemmas of Government, though, we need housing, and if we so design our programs that they are not going to be——

Mr. STAATS. We have certainly provided, as we see it, the incentives for section 236 at the front end of the time period of that housing, and we have got to find some better way to sustain that interest for the longer life of the structure itself, 20 to 25 years.

Representative CONABLE. I have the impression from serving on the tax committee that housing provides a much better tax haven for investment, than, for instance, oil, which is such a symbol of the need for tax reform to so many people. I feel the dilemma that I think

most of my colleagues feel: they want to be sure we have incentives to provide needed housing. Yet in the process of creating the incentives to make this an attractive area for investment we have also created a lot of abuses, and there is no easy answer to it. Certainly, if the Government is going to allow its name and its reputation to be associated with the meeting of a need, like this credibility, requires us to insist on a pretty high standard. But by putting standards far above what we may for the private sector, we insure that this type of housing is going to be too expensive to be a very significant factor in the whole process of housing our people, and that somehow we have got to find some way of achieving our goals in a realistic way, at the same time we do not contribute to the sense of estrangement and alienation, that is so prevalent about the Government programs. I am just expressing a dilemma. That is all.

Chairman PROXMIRE. Very well expressed, and I certainly share it. Congressman Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman. I gather from the discussion here today that the problem of foreclosures is not great solely with subsidized housing but it also goes back to the 221(d)(2) program which was a low down payment, below income payment homeownership, is that not true? In other words, it is not subsidized programs that are creating the problem. It is the degree to which we are putting families into homes though perhaps they cannot bear the burden of homeownership; is that a fair statement?

Mr. BIRKLE. That is a fair statement. The highest foreclosure rate today is on the 221(d)(2) program, which is a nonsubsidized program.

Representative BLACKBURN. That was in effect a precursor of your program. We are putting payments on 221(d)(2) where they were putting them on 235.

Mr. BIRKLE. It is still being used; 221(d)(2) is still being used.

Representative BLACKBURN. Well, in view of that, I am somewhat baffled at the chairman's observation that the programs have an intrinsic value. The problem is that we have been putting families into homes who have no sense of responsibility of homeownership and that is where the problem has been, and that is the intrinsic problem in the program. Is that not true?

Mr. BIRKLE. Well, I think it is a combination of poor management on the part of HUD for both programs, 221(d)(2) and 235, and the fact that many families who had no previous homeownership experience were put into homeownership situations, without adequate screening and counseling on the part of HUD.

Representative BLACKBURN. Well, we found samples where there were families who clearly had no business trying to buy a home. For example, we found welfare mothers whose sole income was aid for dependent children, plus other benefits that come from that status in life, and they were put in housing—presumably as owners—and yet they could not even fix a faucet washer.

Have we concluded there are some people who should not be put in the status of home purchasers? Can we not conclude that there are some people who do not have the sense of responsibility or the economic income to own a home?

Mr. STAATS. That is undoubtedly true. I think pertinent to your question and your observation, the Farmers Home Administration seems to have done a better job of counseling and their default rate is lower. They have been more successful in finding people who are suitable for homeownership.

Representative BLACKBURN. And build better homes for the same dollar, too, I understand. They deliver a better house for the same dollar.

Mr. STAATS. I think Mr. Birkle might elaborate on this point a little bit and describe perhaps the way the Farmers Home Administration carries out this particular function.

Mr. BIRKLE. Well, the county agent in the Farmers Home Administration deals directly with the prospective homeowner, and will counsel the homeowner on whether or not, at a point in time, he should undertake the additional expense of trying to buy a home. He will help him with debt management problems, and maybe arrange so that he can come back a few months later, or a year later, when he has some of his existing debts paid off, and then he will be ready for homeownership. This type of counseling has not been carried out on the HUD programs.

As to your point about getting more home for the dollar, I think it is true that the cost of a comparable house under the Farmers Home Administration program is a little less than it is under HUD. I think the settlement costs are less under Farmers Home Administration, and also Farmers Home generally does not provide as much landscaping and some of the other amenities that would go into a home that HUD might be financing in a more urban area.

Representative BLACKBURN. They are probably able to buy their land somewhat cheaper too, in the more rural areas.

Mr. BIRKLE. That would probably be true; yes.

Representative BLACKBURN. Well, I appreciate your testimony. I still feel that what your testimony has reemphasized is the inability of Government, in many instances, to deal with problems. I just feel we must keep the private sector very heavily involved. I remember the scandals of the old 608 program which resulted in loans covering not only the cost of the building, but the land as well, and a windfall to the speculator. So any time you get Government totally involved, as it is now with the total guarantees and this sort of thing, I think you encourage the sharp operator to move into the business to the extent that private enterprise has an investment, and I think that is one of the real criticisms of this program. We have protected the lender completely, and I think he ought to share some of the loss. And if he did, he would look at the value of that land, and he would say, "Wait a minute, I know the fellow next door just bought a hundred acres at 50 percent less or one-third of what they have appraised this land, I am not going to loan money like that on this land." I think that is what we must do to bring the discipline of the marketplace back into these programs, and that is what is lacking now, in my opinion.

Mr. STAATS. You have to have a very tough attitude to be sure you eliminate that sharp operator from doing business again.

Representative BLACKBURN. Maybe we can put some of them in jail.

Chairman PROXMIRE. We have to do it in a way, I think, in which the Conable colloquy just emphasized, that you do not kill the program. We have to build homes, provide homes for low-income people. It is not easy, and there are going to be lots of problems along the way. But I think your testimony this morning is very helpful, especially the last points made by Mr. Birkle with respect to the county agent counseling and 502 being so much more effective than the 221, 235 programs in screening and advising, and suggesting to prospective homeowners they might not be eligible.

I want to thank you very, very much, Mr. Staats, for a fine job in a very difficult area.

Mr. STAATS. Thank you very much.

(The following information was subsequently supplied for the record by Mr. Staats:)

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-171630 December 29, 1972

Dear Mr. Chairman:

Enclosed is a copy of our report to the Congress on opportunities to improve effectiveness and reduce costs of homeownership assistance programs of the Department of Housing and Urban Development and the Department of Agriculture.

The report's findings and recommendations, as well as those in our soon to be released report on the rental housing subsidy program, were included in our statement before the Subcommittee on Priorities and Economy in Government, Joint Economic Committee, on December 4, 1972. A copy of the rental subsidy report will also be provided to the Subcommittee.

The report points out that:

--The Departments, in allocating program resources, did not insure that all eligible families had the same opportunity to participate in the programs regardless of where they lived.

--Houses with significant defects were sold.

--The Departments had not provided field offices with adequate guidelines on the types of housing eligible under the programs for low- and moderate-income families.

--Preliminary information indicates that mortgage defaults could become a major problem in administering the programs.

We are making several recommendations to the Secretary of Housing and Urban Development and to the Secretary of Agriculture.

We previously recommended that the Congress consider amending the legislation for Agriculture's homeownership assistance program to require direct Federal financing.

B-171630

In this report we are recommending that the Congress consider similar legislation for the Department of Housing and Urban Development's program. Such financing could save about $1 billion.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Enclosure

The Honorable William Proxmire
Chairman, Subcommittee on Priorities and
Economy in Government
Joint Economic Committee
Congress of the United States

REPORT TO THE CONGRESS

Opportunities To Improve Effectiveness And Reduce Costs Of Homeownership Assistance Programs

B-171630

Department of Housing and Urban Development
Department of Agriculture

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-171630

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on opportunities to improve effectiveness and reduce costs of homeownership assistance programs of the Department of Housing and Urban Development and the Department of Agriculture.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Housing and Urban Development; the Secretary of Agriculture; and the Secretary of the Treasury.

Elmer B. Staats

Comptroller General
of the Unites States

Contents

ABBREVIATIONS

FHA	Farmers Home Administration
GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget
SMSA	standard metropolitan statistical area
USDA	Department of Agriculture

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

OPPORTUNITIES TO IMPROVE EFFECTIVENESS AND REDUCE COSTS OF HOMEOWNERSHIP ASSISTANCE PROGRAMS
Department of Housing and Urban Development
Department of Agriculture
B-171630

D I G E S T

WHY THE REVIEW WAS MADE

Low- and moderate-income families are assisted in becoming homeowners through mortgage insurance, loans, and interest subsidies administered by the Department of Housing and Urban Development (HUD) and the Department of Agriculture (USDA).

National goals announced in 1970 called for about 2.8 million families to receive these types of assistance by 1978. HUD's program costs are estimated to range from $10.5 billion to $36.9 billion. At June 30, 1972, HUD had expended about $379 million for homeownership assistance payments. No estimate was available of USDA's total costs; however, as of June 30, 1972, USDA estimated that its subsidy program had cost $37 million.

Because of the magnitude of Federal funds involved and indications of problems encountered in administering the programs, the General Accounting Office (GAO) reviewed the programs to determine whether HUD and USDA could improve program effectiveness and reduce costs.

Specifically, GAO examined the allocation of program resources, quality of housing provided, mortgage default rates, housing options provided, and method of financing.

FINDINGS AND CONCLUSIONS

Allocation of program resources

HUD and USDA, in allocating program resources, did not insure that all eligible families had the same opportunity to participate in the programs regardless of where they lived.

The need for subsidized housing had not been identified adequately and was not used as the primary basis for allocating limited resources.

HUD headquarters' estimates of subsidized housing needs differed from its field offices' estimates, and the differences were not reconciled adequately. Neither USDA headquarters nor its field offices had developed estimates of rural subsidized housing needs as a basis for allocating program resources. (See p. 10.)

An area's capacity to produce housing was a major factor in distributing HUD program resources at both national and local levels. Allocations of USDA program resources at the national level were based primarily on prior years' housing production. Allocations at the local level were primarily on a first-come, first-served basis. (See p. 12.)

Condition of housing

Houses with significant defects were sold under the homeownership

assistance programs. Many of the defects concern the safety and health of occupants, and the objective of providing low- and moderate-income families with decent, safe, and sanitary housing was not met. Families that obtained such houses could face unexpected financial hardships in correcting defects or could give up houses because of dissatisfaction. (See pp. 24 and 29.)

HUD and USDA have taken or have planned actions to improve inspection procedures and to insure that defects are disclosed before houses are approved for mortgage insurance or loans. (See p. 31.)

Additional procedures, however, are needed to provide for reinspecting all houses within the 1-year period during which purchasers are protected under builders' service policies and sellers' certifications. Purchasers of existing rural housing also need a right of recourse similar to that of purchasers of urban housing. (See p. 33.)

Housing options

HUD and USDA had not provided field offices with adequate guidelines on the types of housing eligible under homeownership assistance programs. Some families could buy houses with such options as air conditioning, fireplaces, or extra bathrooms, while other families could not. (See pp. 34 and 36.)

HUD needed to clarify the application of statutory ceilings up to which it could insure mortgages and of its administrative directive limiting assistance to the cost of a "moderate house." USDA needed to apply more uniformly its criteria for the type of housing that could be subsidized and to cooperate with HUD in applying common standards in communities served by both agencies. (See p. 38.)

Mortgage defaults

Preliminary information indicated that mortgage defaults could become a major problem in administering the programs. Recent experience at HUD indicates a 10-percent default rate. Such a rate would reduce program effectiveness and could result in costs to HUD of about $532 million to manage and dispose of acquired properties. Therefore, HUD and USDA should analyze the causes of defaults and identify ways of reducing the default rate. (See p. 41.)

Method of financing

HUD could save about $1 billion if its homeownership assistance program were financed through Government borrowings rather than through private lenders because of the lower interest rate at which the Government could borrow. (See p. 46.)

HUD and USDA internal audits

In fiscal years 1971 and 1972, HUD's and USDA's audit staffs reported significant weaknesses in homeownership assistance programs managed by their agencies. GAO has summarized the audit findings and corrective actions taken or planned by HUD and USDA. (See p. 52.)

RECOMMENDATIONS OR SUGGESTIONS

HUD and USDA should:

--Insure that program resources are

allocated primarily in proportion to identified needs. (See p. 23.)

--Reinspect all houses within the 1-year warranty period after purchases to insure that housing defects have been properly identified and corrected. (See p. 33.)

--Clearly define the types of housing that may be subsidized in various areas of the Nation and cooperate in applying common standards for houses being provided in communities served by both agencies. (See p. 39.)

--Require in-depth studies to determine reasons for defaults and use such studies to develop guidelines for screening and counseling program applicants. (See p. 45.)

USDA should:

--Make separate allocations of program resources for subsidized and unsubsidized housing loans according to need. (See p. 23.)

--Establish procedures or seek legislation, if necessary, to provide the purchasers of existing rural housing with a right of recourse to the sellers for defects existing at the time of purchase. (See p. 33.)

AGENCY COMMENTS AND UNRESOLVED ISSUES

Allocation of resources

HUD has increasingly considered needs in its allocation of program resources, but because a number of States have not received their proportionate share, HUD must first identify the true needs and allocate resources in accordance with them.

USDA has directed that at least 50 percent of its program resources be allocated to subsidized rural housing; needs for such housing should be determined. (See p. 22.)

Reinspection of housing

HUD and USDA have agreed, within the constraints of available funding, to make reinspections. (See p. 33.)

Housing options

HUD and USDA cited actions taken subsequent to GAO's review to clarify the types of housing to be provided under their programs. (See p. 40.)

Mortgage defaults

HUD and USDA mentioned procedures for determining and listing causes of defaults; they should give attention to analyzing causes of defaults and minimizing future defaults. (See p. 45.)

Method of financing

HUD, the Treasury Department, and the Office of Management and Budget agreed that the cost of direct Government financing would be lower than financing through private lenders but said that factors other than cost must be considered and made certain observations on behalf of the present method of financing. (See p. 49.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should consider legislation which would permit HUD's homeownership assistance program to be financed by the

Government rather than by private lenders, because of the possible saving in interest costs. GAO previously made a similar recommendation to the Congress on legislation for financing rural housing programs. (See p. 51.)

CHAPTER 1

INTRODUCTION

The Housing Act of 1949 (42 U.S.C. 1441) expressed a national objective of a "decent home and a suitable living environment for every American family." In the Housing and Urban Development Act of 1968 (42 U.S.C. 1441a), the Congress reaffirmed that objective and established a national goal of producing and rehabilitating 26 million housing units by 1978--6 million units to be provided to low- and moderate-income families with some form of Federal assistance. Half of the 6 million units will be houses that such families can buy with Federal financial assistance. The Federal Housing Administration of the Department of Housing and Urban Development (HUD) and the Farmers Home Administration (FHA) of the Department of Agriculture (USDA) are authorized to provide this financial assistance under two programs--the section 235 and section 502 programs.

SECTION 235 PROGRAM

Section 235 of the National Housing Act, as amended (12 U.S.C. 1715z), which was added by section 101(a) of the Housing and Urban Development Act of 1968, authorizes HUD to assist low- and moderate-income families in becoming homeowners by providing mortgage insurance and subsidizing portions of the monthly payments due under the mortgages for principal, interest, taxes, insurance, and mortgage insurance premiums.

Generally, to be eligible, a family must have an adjusted income which does not exceed 135 percent of the income limit established in the area for initial occupancy of public housing. Family assets cannot exceed $2,000 if the applicant is under 62 years of age, $25,000 if the applicant is between the ages of 62 and 64, and $35,000 if the applicant is 65 years of age or over. The family asset limitation may be increased by $500 for each dependent, plus an amount equal to the applicant's share of the mortgage payment for 1 year.

The purchaser is required to pay at least 20 percent of his adjusted income toward the total monthly mortgage payment. HUD pays the balance of the required monthly

payment; however, HUD's payments cannot exceed the difference between the total required monthly payment for principal, interest, and mortgage insurance premium and that amount which would be required for principal and interest if the mortgage bore interest at a rate of 1 percent.

HUD requires a purchaser's income to be recertified every year to adjust assistance payments. As long as the required monthly mortgage payment exceeds 20 percent of the purchaser's adjusted monthly income, he will receive a subsidy even though his income exceeds the limits set for eligibility at the time of purchase. Assistance payments can be made to purchasers of either new houses (houses constructed or substantially rehabilitated in accordance with HUD-approved plans and specifications) or existing houses. Under current law, only 30 percent of the authorized funds can be used to assist families to purchase existing houses.

Under the section 235 program, HUD generally assists low- and moderate-income families in urban areas. The authorizing legislation provides that the Secretary of HUD assign a portion of the authority to make assistance payments to the Secretary of USDA to use in rural areas and small towns. An agreement between HUD and USDA stipulated that assistance payments authorized by USDA would be limited to rural areas. Through June 30, 1971, USDA had processed about 4 percent of the total section 235 loans.

The basic statutory mortgage limits for single-family dwellings are $18,000 for a family of four or less and $21,000 for a family of five or more. These limits may be exceeded by $3,000 in high-cost areas.

SECTION 502 PROGRAM

Section 502 of the Housing Act of 1949 (42 U.S.C. 1472a) authorized USDA to make housing loans in rural areas. Section 1001 of the Housing and Urban Development Act of 1968 amended section 502 to provide subsidized loans to low- and moderate-income families if their need for housing could not be met with financial assistance from other sources, including assistance available under section 235. The subsidy (interest credit) can reduce the homeowner's interest rate to as low as 1 percent.

To be eligible for an interest credit loan, the applicant's adjusted annual income cannot exceed $7,000 and his net worth cannot exceed $5,000 when the loan is made. As under the section 235 program, a borrower eligible for a subsidy is required to make mortgage payments which are at least 20 percent of his adjusted income.

USDA and the borrower execute an initial interest credit agreement covering the time from loan closing to the end of the following calendar year. A new loan agreement is executed every 2 years to adjust the amount of the monthly payment. However, unlike the section 235 program, the borrower will no longer be eligible for a subsidy after his adjusted income exceeds the maximum established for his State, even though 20 percent of his adjusted income would be inadequate to make the total required mortgage payment.

No maximum mortgage amounts are set for section 502 loans; however, USDA regulations state that the home should be modest in design, cost, and size.

TARGETS AND ACCOMPLISHMENTS

The Congress directed the President to set production targets for each of the major housing programs for low- and moderate-income families during the 10-year period ending June 30, 1978, and to report each year on the accomplishments. Following are the reported targets and related accomplishments for the sections 235 and 502 programs.[1]

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[1]The targets are those included in the President's Second Annual Report on National Housing Goals, dated April 1970. The accomplishments are those included in the Fourth Annual Report on National Housing Goals, dated June 1972.

Fiscal year	Section 235 Targets	Section 235 Accomplishments	Section 502 Targets	Section 502 Accomplishments
	(Thousands of units)			
1969	3	8	33	33
1970	48	70	63	48
1971	145	138	121	83
1972	141	141[a]	172	87[a]
1973	175		172	
1974	175		172	
1975	175		172	
1976	175		172	
1977	175		172	
1978	174		171	
	1,386		1,420	

[a]Estimated.

Targets for the section 502 program include loans to both borrowers who are eligible and borrowers who are not eligible for interest credit loans. Separate targets for housing to be provided under interest credit loans have not been established.

Targets have not been set for the number of existing units to be provided under either program, and they do not count toward meeting the housing goals because they do not add to the housing supply. However, during fiscal years 1969, 1970, and 1971, about 31,000 existing units were provided to low- and moderate-income families under section 235 and about 25,000 units were provided under section 502.

ESTIMATED SUBSIDY PAYMENTS

Subsidies for the 1.4 million new and rehabilitated housing units planned under the section 235 program could amount to $10.5 billion. This estimate is based on information which HUD provided to the Congress in April 1972 on estimated payments under section 235 contract authorizations granted through 1972. The information indicated that the average purchaser would be eligible for a subsidy of about $7,600 over 12 to 14 years. If the purchaser remained eligible for a subsidy for the full 30-year term of the mortgage

loan, the subsidy payments could amount to about $26,600 for each loan, or about $36.9 billion for the total program. At June 30, 1972, HUD had expended about $379 million in home ownership assistance payments.

Since USDA has not established separate targets for the housing units to be provided under section 502 interest credit loans, the subsidy cost for this program has not been determined. However, as of June 30, 1972, USDA estimated that its subsidy program had cost about $37 million.

SCOPE OF REVIEW

We reviewed selected aspects of the two loan programs because preliminary information indicated that HUD and USDA could improve program effectiveness and reduce costs. We reviewed the allocation of program resources, quality of housing provided, mortgage default rates, housing options provided, and method of financing.

Also, we considered HUD's and USDA's recent, comprehensive internal audits of the sections 235 and 502 programs.

Our review was generally confined to HUD and USDA activities in nine States--Alabama, Arkansas, Colorado, Georgia, Louisiana, South Carolina, Texas, Washington, and Utah--where about 38 percent of the section 235 loans and about 29 percent of the section 502 loans had been made from August 1968 through December 31, 1970. We interviewed HUD officials at headquarters, regional, and local levels and USDA officials at headquarters, State, and local levels. We examined pertinent legislation, administrative regulations, and program records. We inspected houses provided by USDA and monitored HUD's inspection of selected houses.

We also interviewed officials from the mortgage banking industry about certain aspects of loan processing and servicing.

CHAPTER 2

ALLOCATION OF PROGRAM RESOURCES

HUD and USDA did not allocate program resources[1] to insure that all eligible families had the same opportunity to participate in the homeownership assistance programs regardless of where they lived. For an equitable distribution of their limited program resources, the two agencies should better identify the housing needs of lower income families and should distribute program resources primarily in proportion to identified needs.

HOUSING NEEDS NOT ADEQUATELY IDENTIFIED

HUD headquarters and field offices have estimated housing needs for lower income families; however, these estimates differed greatly and HUD did not reconcile them to arrive at reasonably reliable data. Neither USDA headquarters nor its field offices had developed estimates of rural subsidized housing needs for use in its allocation process.

HUD estimates of need

To estimate the needs for subsidized housing for each standard metropolitan statistical area (SMSA)[2] and for each county with an urban center having a population of 8,000 or more, HUD headquarters updated 1960 census data on households and conditions of housing to reflect intervening construction, demolition, housing deterioration, growth in number of households, aging of population, and changes in

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[1]HUD program resources consist of authorizations to enter into contracts with lenders for paying subsidies. USDA program resources consist of the authority to make housing loans.

[2]An "SMSA" is generally defined as a county or group of contiguous counties which contain at least one city of 50,000 inhabitants or more or twin cities with a combined population of at least 50,000.

family income levels and distributions. HUD annualized the total estimates to reflect that portion of an area's needed units which, if provided, could be sold during a 1-year period.

Field office need estimates were to reflect the maximum number of subsidized housing units which could be sold in an area during a 1-year period. Field office personnel were allowed little time to prepare the estimates, and they told us that their estimates could be nothing more than educated guesses.

HUD headquarters' estimates and the field offices' estimates differed greatly; however, HUD did not reconcile these differences but instead used an average of both estimates in its allocation formula. For example, headquarters estimated that one field office needed about 6,600 units, whereas that field office estimated only about 2,000 units. Although the headquarters' estimate was over three times that of the field office, HUD used an average of 4,300 to determine how program resources would be allocated in fiscal year 1971.

Needs not identified by USDA

Neither USDA headquarters nor the nine USDA State offices included in our review had estimated the needs for subsidized rural housing. However, one USDA State director had begun a study to estimate housing needs projected to 1980, so that the county offices, as well as the builders, could be directed to areas in need.

NATIONAL ALLOCATION OF PROGRAM RESOURCES

A major factor in determining where HUD resources were to be allocated was an area's capability to produce housing. USDA's allocations were based primarily on prior years' production. As a result, not all areas of the Nation participated in the homeownership assistance programs in proportion to their indicated needs.

Allocation of HUD program resources

HUD allocated section 235 program resources to its 77 field offices primarily on the basis of a formula which considered production capacities and estimated needs for subsidized housing in the areas served by the field offices. The allocation formulas used prior to March 1971 emphasized production capacities rather than estimated needs; therefore, areas most active in producing subsidized housing received a greater proportion of the available program resources. HUD recognized that need is an important factor in allocating limited program resources and has taken some action to increase emphasis to this factor in allocating section 235 program resources. In the March 1971 allocation, HUD gave equal weight to subsidized housing needs and production capacities. In the fiscal year 1972 allocation, HUD changed the relative weights assigned to these two factors to 60 percent and 40 percent, respectively.

HUD reassigned program resources among field offices when field offices had not used their allocations promptly. For example, to meet production goals for calendar year 1970, HUD reassigned program resources during December to various field offices on the basis of their areas' ability to start construction by the end of the year. HUD provided enough contract authority to two field offices in December 1970 to enable them to increase calendar year 1970 construction starts in their areas by over 65 percent. HUD records show that construction starts in these two areas totaled about 2,865 units in the last 3 weeks of December 1970.

HUD officials advised us that the headquarters' estimates were the best approximation of nationwide needs for subsidized housing. Therefore, we compared the actual distribution of housing units provided under section 235 from program inception (August 1968) through December 1971 with

headquarters' estimates of housing needs by individual States. Because HUD's rental assistance program, authorized by section 236 of the National Housing Act, serves the same income group as the section 235 program, HUD developed one combined estimate of housing needs to be met by both programs. Therefore, our comparison includes housing units provided under both these programs.

Our analysis showed that several States received far fewer housing units than their share as indicated by estimated housing needs. This was especially true for the Northeastern States.[1] About 11 percent of the housing units provided through December 1971 were in the Northeastern States, which would have received about 32 percent of the housing units had they been allocated on the basis of HUD need estimates. Following is the national ranking of selected States based on HUD headquarters' estimates of needs compared with the housing units provided. (See app. I for a ranking of all States.)

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[1]As classified by the Bureau of Census.

	Estimates of needs (note a)		Housing units provided August 1968 through December 1971					
			Total		Section 235		Section 236	
State	Units	Rank	Units	Rank	Units	Rank	Units	Rank
Northeast:								
N.J.	25,980	7	4,815	32	2,460	31	2,355	27
N.Y.	110,770	1	11,855	13	2,633	30	9,222	6
Pa.	39,440	4	11,750	14	3,700	27	8,050	7
South:								
N.C.	13,130	15	8,145	21	5,098	19	3,047	20
W. Va.	3,835	36	1,261	45	599	44	662	43
North Central:								
Mo.	13,770	12	6,772	27	3,775	26	2,997	21
Wis.	13,725	13	7,562	24	5,400	17	2,162	31

[a]These estimates, based on data furnished by HUD headquarters, represent the needs for units which could be sold in a 3-year period.

Allocation of USDA program resources

USDA has allocated section 502 program resources to each of its State offices and its offices in Puerto Rico and the Virgin Islands primarily on the basis of prior production. USDA made allocations to State offices in aggregate for all section 502 loans; it made no separate allocations for loans to borrowers who are eligible to receive interest credit loans. However, in June 1971 USDA headquarters directed that at least 50 percent of all section 502 loans authorized for fiscal year 1972 would be made to lower income families.

We compared the distribution of housing provided under the section 502 program from August 1968 through December 1971 with rural census population statistics because estimates of rural housing needs were not available. We recognize that population statistics may not be an accurate indicator of housing needs; however, we did find a high correlation between State population statistics and HUD's estimates of subsidized urban housing needs (see app. I), and a similar correlation may exist for subsidized rural housing needs.

About 10 percent of the housing units provided by USDA under the section 502 program were in the Northeast States, which had about 18 percent of the Nation's rural population, and about 23 percent were in the North Central States, which had about 30 percent of the Nation's rural population. About 58 percent of the housing units provided were in the South, which had about 41 percent of the Nation's rural population.

The State rankings by rural population differed greatly from those by the number of housing units provided under section 502. The following schedule shows the national ranking for several States. (See app. II for a ranking of all States.)

State	Rural population ranking	Housing units provided under USDA's section 502 program August 1968 through December 1971					
		Total		Interest credit loans		Other loans	
		Units	Rank	Units	Rank	Units	Rank
Northeast:							
Maine	34	5,175	19	2,185	12	2,990	23
Pa.	1	4,101	23	695	27	3,406	21
South:							
Ark.	24	12,837	5	5,302	3	7,536	6
Miss.	21	15,616	2	5,849	2	9,767	2
North Central:							
Mich.	5	6,748	14	1,553	17	5,195	14
Ohio	4	5,924	17	1,358	20	4,566	18

Through June 30, 1971, USDA, acting as HUD's agent in rural areas for approving section 235 home ownership loans, approved about 7,360 loans. USDA administered program resources at the national level and made them available to borrowers on a first-come, first-served basis. As a result, about 26 percent of the loans approved by USDA in fiscal years 1970 and 1971 were in one State (Washington) which accounted for only about 2 percent of the Nation's rural population. During the 18-month period ended December 31, 1970, over half of the loans were made in one county of this State.

LOCAL ALLOCATION OF PROGRAM RESOURCES

A basic problem encountered by HUD and USDA field offices was inadequate guidance by headquarters on the procedures and policies to follow in allocating program resources. Left on their own, most of the offices allocated resources on a first-come, first-served basis and therefore did not allocate program resources according to needs.

Allocation of HUD program resources

Authority to approve section 235 loans was first delegated to field offices in July 1969. At that time, HUD instructed the offices to serve those communities with the greatest needs for housing and to make every effort to achieve a fair geographic distribution. Although HUD issued many circulars and directives on the operation of the section 235 program, it gave no guidelines on how a fair geographic distribution should be achieved.

Field offices used various methods of allocating program resources. Many field offices covered by our review did not use their own or headquarters' need estimates as a basis for allocating resources. There were wide variations in the extent to which the housing provided met the needs for subsidized housing in the areas served by the field offices.

Many of the field offices relied on builders to determine the locations of houses. For example, the Denver field office--which serves Colorado--allocated its funds for new units according to builder requests and each builder received a portion of the funds. Few builders submitted proposals to build in small communities; therefore, larger communities received a disproportionate share of available resources. In Colorado 5,501 of 6,051 houses provided from August 1968 through December 1971 were in the three SMSAs of the State, while only 550 houses were in the rest of the State. Following is a comparison of the actual distribution of houses in Colorado with need estimates developed by HUD headquarters. As mentioned earlier, we included the housing units provided under the sections 235 and 236 programs in our comparison because these programs serve the same income group.

SMSA or county	Housing units provided from August 1968 through December 1971 Section 235	Section 236	Total units	Estimated needs Units (note a)	Percent of needs met
SMSAs:					
Colorado Springs	1,366	439	1,805	964	187
Denver	3,685	2,467	6,152	4,126	149
Pueblo	450	245	695	437	159
County:					
Fremont	1	-	1	53	2
La Plata	5	-	5	55	9
Larimer	69	24	93	393	24
Las Animas	-	-	-	45	-
Logan	2	-	2	55	4
Mesa	17	90	107	192	56
Otero	5	-	5	121	4
Weld	57	-	57	318	18
Other	394	42	436	(b)	-
Total	6,051	3,307	9,358	6,759	138

[a]See note on page 13.

[b]Needs were not estimated for these counties.

At the Columbia, South Carolina, field office, we were told that funds were generally allocated on the basis of how much confidence the office had in the builders who submitted proposals. A comparison of the actual distribution of houses with HUD's need estimates shows that the percent of needs met ranged from a low of 4.4 percent in one county to over 300 percent in another.

The director of the Seattle, Washington, field office told us that builders usually determined the locations of section 235 housing. Our analyses again showed a concentration of houses in the State's two SMSAs and a wide variance in percent of needs met.

SMSA or county	Housing units provided from August 1968 through December 1971			Estimated needs	
	Section 235	Section 236	Total units	Units (note a)	Percent of needs met
SMSA:					
Seattle-Everett	4,583	2,593	7,176	4,608	156
Tacoma	1,708	655	2,363	1,757	134
County:					
Chelan	18	-	18	207	9
Clallum	11	-	11	130	8
Cowlitz	33	145	178	245	73
Grays Harbor	57	-	57	214	27
Island	24	-	24	90	27
Kitsap	98	36	134	396	34
Kittitas	4	168	172	99	174
Skagit	228	46	274	172	159
Thurston	143	-	143	285	50
Whatcom	108	82	190	307	62
Yakima	298	-	298	721	41
Total	7,313	3,725	11,038	9,231	120

[a]See note on page 13.

The Seattle field office began allocating resources to counties on the basis of indicated needs after we discussed the results of our review with the office. Under this method the director of the office informed builders and mortgagees of the number of houses which would be financed in each county under the section 235 program. Also the office planned to record the locations of housing provided to determine how well the needs of each area had been met.

The Spokane, Washington, field office allocated resources in a planned, consistent manner starting in calendar year 1970. It allocated program resources equally between the one metropolitan area and outlying areas within its jurisdiction. It reviewed prior allocations and gave higher priorities to those areas which had not received their shares. As the following analysis shows, this method resulted in a

somewhat more equitable distribution of resources between SMSAs and non-SMSAs than the methods used by the offices previously discussed.

SMSA or county	Housing units provided from August 1968 through December 1971 Section 235	Section 236	Total units	Estimated needs Units (note a)	Percent of needs met
SMSA:					
Spokane	1,514	612	2,126	1,115	191
County:					
Benton (Wash.)	146	-	146	144	101
Franklin (Wash.)	100	54	154	108	143
Grant (Wash.)	48	37	85	116	73
Walla Walla (Wash.)	132	48	180	180	100
Whitman (Wash.)	47	100	147	126	117
Kootenai (Idaho)	101	66	167	117	143
Latah (Idaho)	25	55	80	119	67
Nez Perce (Idaho)	109	-	109	110	99
Total	2,222	972	3,194	2,135	150

[a]See note on page 13.

Allocation of USDA program resources

USDA State offices made section 502 program resources available to county offices largely on a first-come, first-served basis. No guidance had been provided to State or county offices on how to distribute program resources, so distribution was left to individual county supervisors.

The State offices included in our review had not determined the needs for subsidized housing. The locations

of section 502 housing in many States was determined primarily by builders and realtors, and loans were not distributed among counties according to population data. For example, in Georgia, no section 502 interest credit loans were made in one county with a rural population of about 19,000 from July 1, 1968, to May 20, 1971, while 135 interest credit loans were made during the same period in another county with approximately the same rural population. In Texas 16 section 502 interest credit loans were made in one county from July 1, 1968, through March 31, 1971, while 153 section 502 interest credit loans were made during the same period in an adjacent county with a similar rural population.

USDA's Office of Inspector General (OIG) reported that some county offices were making only limited use of interest credit loans. In a January 1970 audit report, OIG commented that:

> "*** loans are *** made primarily on a 'first-come first-served' basis, i.e., the county supervisor who gets the largest amount of loan dockets to the National Finance Office will make the largest amount of loans. Meanwhile, it is entirely possible that residents of areas served by other unit offices will not receive loans needed equally as much primarily because (a) the county supervisor in their area was not as adept in completing loan dockets; or (b) the county supervisor lacked initiative, ingenuity, or resourcefulness in making known to potential borrowers the manner in which FHA [Farmers Home Administration] loan programs could assist them."

In another audit report issued in August 1971 on the rural housing program, OIG pointed out that:

> "FHA is not adequately meeting its Rural Housing Program objective of providing safe, decent, and sanitary housing for low to moderate income families. This is occurring because: (1) the objectives of the currently funded Rural Housing Program are neither clearly understood nor fully accepted at State and county office levels in

some locations; and, (2) currently there is neither adequate National Office monitoring of field operations nor an effective system for qualitatively measuring the extent to which program objectives are understood and accomplished. As a result, the housing needs of lower income families, in some areas, are not being adequately served ***."

AGENCY COMMENTS AND OUR EVALUATION

HUD views

In commenting on our proposal that HUD provide for a more equitable distribution of program resources, HUD stated (see app. IV) that it had increased emphasis on needs in its allocation formulas, to a point where it gave needs a 60-percent weight in the fiscal year 1972 allocation formula. We believe, however, that HUD must first identify the true needs for subsidized housing. As a minimum, this would require that HUD headquarters need estimates and its field offices' estimates be coordinated, to arrive at reliable data. After HUD has determined needs, it should make every effort to allocate program resources according to the needs, even if this requires special actions or programs to spur the development of subsidized housing in certain areas.

HUD agreed that field offices should be more active in determining the areas' needs for subsidized housing and should give priority to developing areas with the greatest needs. Statutory limitations, restrictive income limits, increasing land costs and taxes, and the conservative attitudes of some banking institutions, according to HUD, had contributed to the disparity between the estimated needs for subsidized housing in the Northeastern States and the housing units actually provided. HUD stated that the proposed Housing and Simplification Act, which the 92d Congress considered but did not enact, would improve this situation by permitting the Secretary to administratively determine mortgage and income limits.

USDA views

USDA informed us (see app. V) that its allocation of rural housing funds to States considers such factors as number of rural homes, conditions of homes, incomes of rural families, average costs of new homes, and historical lending patterns. USDA expressed the view that it is distributing the funds to States in accordance with needs.

Although USDA considered the cited factors when it distributed section 502 funds, historical lending patterns (prior production) were a major factor influencing such distribution. For example, the initial distribution of

fiscal year 1971 funds was based primarily on fiscal year 1970 distribution.

USDA advised us that for fiscal year 1973 it ranked the States for each of the five factors mentioned above and then adjusted the ranking on the basis of historical lending patterns to decide whether a State should receive a greater or lesser proportion of the total program resources than it did the previous year. We believe that this procedure continues to give undue weight to prior production instead of current needs.

USDA did not comment on the allocation of section 502 resources at the State or local level or on making allocations on a first-come, first-served basis or on the basis of the actions of builders and realtors.

USDA acknowledged that it had made no separate allocations of interest credit loans under the section 502 program but informed us that it would instruct the States to channel at least 50 percent of the loan funds into housing for low-income families. We question whether allocating loan funds on the basis of a predetermined nationwide percentage would adequately meet the housing needs of low-income families.

RECOMMENDATIONS

We recommend that the Secretary of HUD and the Secretary of Agriculture insure that resources under sections 235 and 502 programs are allocated primarily in proportion to needs. We also recommend that the Secretary of Agriculture require separate allocations of the subsidized and unsubsidized housing loans according to needs.

CHAPTER 3

CONDITION OF HOUSING

Houses with significant defects were sold to low- and moderate-income families under the programs. Because many of the defects concern the safety and health of the occupants, the program objective of providing low- and moderate-income families with decent, safe, and sanitary housing has not been met in many cases. Also, the families that obtained such houses could face unexpected financial hardships in correcting the defects or could give up the houses because of dissatisfaction.

HUD and USDA have taken some corrective actions and plan to take others. At the time of our review, it was too early to test the adequacy of these actions.

DEFECTIVE HOUSES PROVIDED UNDER THE HUD-ADMINISTERED SECTION 235 PROGRAM

A report by the staff of the House Committee on Banking and Currency[1] disclosed that houses with serious defects had been provided to low- and moderate-income families under the section 235 program. As a result of this report, HUD's Office of Audit reviewed HUD's program administration, which included physical inspections of 1,281 properties which HUD had previously inspected and approved. HUD's auditors found that 433 of the 1,281 houses had defects. About 24 percent of the new houses and 39 percent of the existing houses had defects.

HUD's original audit samples of 730 new houses and 633 existing houses were selected, on a statistical random basis, from the approximately 78,700 new houses and 40,600 existing houses insured by HUD at November 30, 1970. The original samples were reduced by 61 houses by eliminating those field offices where there were less than 10 properties

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[1] Investigation and Hearing of Abuses in Federal Low- and Moderate-Income Housing Programs, Staff Report and Recommendations, December 1970.

and by 51 houses where the auditors were unable to enter and inspect the houses. In addition to reviewing the HUD auditors' sampling techniques, we verified their inspection results by inspecting with them, or by reinspecting, 101 houses in 12 cities. On the basis of that review, we believe that the results of the inspections can be projected nationwide. Such a projection indicates that, of those houses insured as of November 1970, about 18,900 new houses (24 percent of 78,700) and 15,800 existing houses (39 percent of 40,600) had defects.

The results of HUD's inspection and descriptions of the defects disclosed are set forth below.

	New houses	Existing houses
Original sample	730	663
Houses inspected	672	609
Houses inspected that:		
Had defects resulting from poor workmanship or materials	100	(a)
Had significant defects affecting safety, health, or livability	73	225
Should not have been insured (note b)	-	35
Total houses with defects	173	260
Percent of houses with defects to original sample	24	39

[a]Not applicable.

[b]HUD's Office of Audit concluded that the significant defects in these houses should have made them ineligible for mortgage insurance.

New houses--poor workmanship or materials. No switch to operate kitchen light; all corners cracked from ceiling to floor; stairway handrail to upper story loose and attached to sheetrock rather than studding; large two-pane picture window had inside portion of mullion missing, which allowed air to enter through crack that extends the full height of window.

New houses--significant defects affecting safety, health, and livability. Leak in drainpipe from kitchen and bath causing water to stand under house; electric circuit breaker cut power off at various times, particularly when furnace and range were both on; 2 to 6 inches of water standing in crawl space due to poor drainage; leak in roof; wingwall separated from main part of house; severe settling of concrete porch; steps separating from porch; no porch handrails; drainage problem because of improperly graded lot.

Existing houses--significant defects affecting safety, health, and livability. House required complete rewiring, and owner received notice of code violation from city; walls cracked throughout house; ceiling tiles falling down; subfloor and floor joists under bathroom and utility areas rotted; all windowsills rotted; roof leaked into kitchen, back porch, dining room, and hall; water in basement due to poor condition of foundation walls; porch deteriorated and handrails rotted; improper lot drainage and water in crawl space.

Our photographs of such defects are included in appendix III.

Inadequate inspection procedures

HUD officials told us that inspections were inadequate because:

1. Appraisers, who are responsible for inspecting properties they appraise and noting conditions needing repair, were not adequately trained to make these inspections. HUD's Office of Audit found a number of cases in which the appraisers had failed to identify significant defects. In other cases, the appraisers noted the defects but the repairs required by the appraisers were inadequate to correct the defects.

2. The emphasis on providing houses placed an unusually heavy workload on field office appraisers. HUD's Office of Audit found that in some field offices appraisers were making five or more appraisals a day. The Office concluded that this workload was unrealistic and resulted in poor inspections because of the time required to appraise and inspect houses, complete paperwork, and find and inspect comparable houses.

3. Appraisers were inadequately supervised. HUD's Office of Audit concluded that many of the appraisal and inspection problems might have been discovered and corrected if supervisory reviews had been made as required.

4. Certain HUD personnel had non-consumer-oriented attitudes toward the section 235 program. HUD's Office of Audit commented on this matter in its December 1971 report.

"Over the past years FHA [Federal Housing Administration] has operated quite successfully as an insurer of mortgages, closely tied into the attitudes and postures of the home building and mortgage banking industries. The organization was not consumer oriented to any significant degree. With the advent of subsidized housing programs (rent supplement and interest subsidies) many of the personnel carrying out programs have not sufficiently adjusted their thinking and attitudes to encompass the Department's new programs.***

"We were informed, both orally and in written comments, that the word was out from the Central Office to relax the inspection requirements. FHA personnel advocated, and continue to do so in certain areas, the 'caveat emptor' concept. They stated that as long as the people were getting better housing than they were accustomed to the goals of the program were being met. The majority of the people housed under Section 235 have received good value and are living in better housing than they were accustomed to.***

"Many buyers of older inner city houses have not been fairly treated. The values stated as the result of

appraisals have been high and the condition of many properties has been poor to bad. *** Policies, procedures and instructions concerning complaints on existing construction were not sufficiently responsive to the homeowner. ***"

DEFECTIVE HOUSES PROVIDED UNDER THE USDA-ADMINISTERED SECTIONS 235 AND 502 PROGRAMS

In eight States we inspected 121 houses provided under the USDA-administered sections 235 and 502 subsidy programs and found that over 50 percent of these houses had defects similar to those found in the HUD-administered program. USDA construction inspectors accompanied us on our inspections and agreed with us on the defects noted and on our classification of them. The number of houses found with defects and descriptions of these defects are summarized below.

	New houses		Existing houses
	Section 235	Section 502	Section 502
Total inspected	41	38	42
Houses with defects resulting from poor workmanship or materials	22	11	(a)
Houses with significant defects affecting safety, health, or livability	7	2	20
Total houses with defects	29	13	20
Percent of houses with defects	71	34	48

[a] Not applicable.

New houses--poor workmanship or materials. Glue penetrating and discoloring the bathroom vinyl flooring; inadequate lot drainage, causing standing water along side of house; exterior door improperly fitted.

New houses--significant defects affecting safety, health, and livability. Septic tank drained into basement; hot-water heater located in attic without pressure release value connected to the outside and no catch pan to handle any water overflow; only one electric heating device for living room, kitchen, and dining area.

Existing houses--significant defects affecting safety, health, and livability. Defective baseboard electric heating device; deteriorated porch steps; gas stove in living room only source of heat for two-story house; collapsed garage roof; steep and narrow stairs without handrails; callapsed cesspool.

Our photographs showing examples of defects in some of the houses we inspected are included in appendix III.

Inadequate inspection procedures

USDA officials advised us that inspections were inadequate because:

1. County supervisors who were not qualified as housing inspectors inspected houses. County supervisors have backgrounds in agricultural management and farm financing but generally do not have sufficient experience or training in homebuilding. An OIG report dated August 1971 stated that more than 96 percent of the professional staff at the county level had educational backgrounds in agricultural management; however, rural housing programs accounted for about 65 percent of FHA's total loan activity.

2. The county office staffs were too small and were technically inadequate to administer the subsidized housing programs as well as other programs. OIG reported that from 1960 to 1971 housing loans increased more than 700 percent while the staff increased only 74 percent. OIG reported over 1,300 deficiencies pertaining to such matters as water and sewage disposal systems, subdivision planning and development, and general construction and noted problems in the inspections, appraisals, and loan servicing done by USDA personnel.

Site and subdivision development standards and technical staff were inadequate. A number of the significant defects found in houses provided under the USDA sections 235 and 502 subsidy programs were due to poor site development, which had caused poor drainage and water accumulation around and under the houses. Some subdivisions approved by USDA

had been previously rejected by HUD because of poor drainage or unacceptable sewage disposal systems. OIG reported that, as of May 1971, USDA had made housing loans in 62 subdivisions in 14 States without adequately planning for overall development of the areas, which had resulted in inadequate water supplies, sewage disposal systems, and road development.

CORRECTIVE ACTIONS TAKEN AND PLANNED

By HUD

To help improve the administration of the section 235 program, HUD has increased its field offices' staff to reduce the workload of appraisers and to allow more time for better inspections.

HUD has conducted training sessions emphasizing quality of inspections and the appraisers' obligations to the purchasers. Field offices have increased their supervisory staff and have reemphasized spot checks of appraisals so that appraisers' work can be reviewed as required.

HUD planned, at the time of our review, to develop a quality control system to insure improved performance at the field level. A professional staff, knowledgeable in mortgage underwriting, housing production, and mortgage credit techniques, was planned to make onsite reviews, evaluate the quality of appraisals and construction inspections made by field personnel, evaluate the correctness of mortgage credit determinations, evaluate the effectiveness of training, determine whether program procedures are being adhered to, and evaluate the effectiveness of regional office supervision. This staff would be directly responsible to the Assistant Secretary for Housing Production and Mortgage Credit.

By USDA

USDA began to train county supervisors in homebuilding in States we visited and proposed similar training for all county supervisors. In addition, some State and county offices either hired or planned to hire additional technical staff, such as construction inspectors.

USDA issued several instructions to its field offices on developing rural housing sites and on establishing standards for acceptability of water and sewage disposal systems. USDA officials advised us that they planned additional actions which include revising site development standards and revising the minimum property standards to closely correlate with HUD's minimum property standards.

USDA issued instructions to field offices on debarring contractors who failed to correct defects and established a technical staff at headquarters to investigate USDA audit findings on housing defects and to serve as a clearinghouse for recommendations as a result of such findings.

STATUTORY PROTECTION

Purchasers of new houses under section 235 have been protected against defects by homeowner service policies which require builders to correct defects during the first year after purchase. This type of protection was not available to purchasers of existing houses until December 31, 1970, when section 518 of the National Housing Act was amended to permit HUD to correct defects which seriously affected the use and livability of any existing house provided under section 235. The defects must have existed on the date of the mortgage insurance commitment and must be reasonably disclosed by proper inspection.

This protection was made available to purchasers whose mortgages were insured before and after enactment of the amendment. Claims by mortgagors insured before enactment must be submitted within 1 year of enactment. Claims by mortgagors insured after enactment must be submitted within 1 year after the mortgages were insured.

In addition, HUD can act against the seller of an existing house needing repairs to recover repair costs. HUD requires that the seller of an existing house certify the present condition of the house and, if he was not the most recent occupant, deposit 5 percent of the purchase price in escrow for 1 year to insure reimbursement should repairs be needed.

Under the section 502 program, purchasers of new houses are also protected against defects by homeowner service

policies provided by builders. However, the statutory protection of purchasers of existing houses provided by section 518, for the section 235 program, is not available under the section 502 program.

Even though purchasers of section 235 houses and section 502 new houses have some protection from defects, low-income families are often unable to detect housing defects and therefore may not request their correction. Therefore, we believe that reinspections of houses by HUD and USDA before expiration of the 1-year period would protect the purchasers and would reduce the costs of needed repairs to be borne by the agency if the purchasers default and the mortgages are foreclosed.

Also protection should be provided to purchasers of existing houses under the USDA section 502 program similar to that of purchasers of houses under section 235.

RECOMMENDATIONS

We recommend that the Secretaries of HUD and Agriculture require that all houses be reinspected within 1 year after purchases to insure that defects covered by builder service policies and sellers' certifications have been identified and corrected.

We also recommend that the Secretary of Agriculture establish procedures or seek legislation, if necessary, to insure that USDA and/or the purchasers of existing housing under section 502 have recourse to the sellers to cover the costs of repairing defects that existed at the time of sale.

AGENCY COMMENTS

In commenting on our recommendation to reinspect houses, HUD pointed out that such a requirement would increase the workload and that, since its budget would not cover the additional staff needed, it might have to use private fee inspectors. USDA stated that, if appropriations permit, it would require reinspections of all houses during the 11th month of the 1-year warranty period.

USDA stated that it would study our recommendation that purchasers of existing housing under the section 502 program be protected by a right of recourse to the seller.

CHAPTER 4

HOUSING OPTIONS

HUD and USDA have not provided their field offices with adequate guidelines on the types of housing eligible under homeownership assistance programs for low- and moderate-income families. As a result, some families can buy houses with such options as air conditioning, fireplaces, and extra bathrooms, while other families in the same general area cannot. Because of these inconsistencies, neither agency can insure that all eligible families are offered the same opportunity to receive the extent of assistance intended by the Congress or that program costs are minimized so that the maximum number of families are assisted with the available funds.

INCONSISTENCIES IN THE SECTION 235 PROGRAM

The initial statutory mortgage limits established for the section 235 program:

	Statutory mortgage limits	
	Basic limit	Limit in high-cost areas
Family of four or less	$15,000	$17,500
Family of five or more	17,500	20,000

In June 1969 HUD instructed its field offices to estimate the cost of a modest house in their jurisdictions to establish administrative mortgage ceilings for the section 235 program. A modest house was described as one containing approximately 1,000 square feet of finished floor space with three bedrooms, one bathroom, and the following options; a refrigerator, a range with a vented hood, and a garbage disposal. Other options, such as a garage, a carport, a patio, carpeting, a fireplace, and air conditioning, were not to be included in the estimate; however, instructions for preparing the estimate stated that such options were not prohibited under the program if they could be produced within the mortgage ceilings applicable to the area.

1969 amendments to the National Housing Act increased the mortgage limits for the section 235 program as shown below.

	Statutory mortgage limits	
	Basic limit	Limit in high-cost areas
Family of four or less	$18,000	$21,000
Family of five or more	21,000	27,000

Because of the increase in mortgage limits, HUD headquarters instructed field offices to prepare new cost estimates for the modest house described above. A February 1970 instruction stated:

> "*** It was never intended that the increase in the 'basic statutory limit' would automatically result in an increase in the actual selling prices under Section *** 235. It was anticipated that in those areas where the typical selling price for a moderate cost, single-family dwelling had been below the new 'basic statutory limit,' most sales under the assisted homeownership program would continue *** at the customary selling prices for 'modest housing' in the area."

Another instruction in March 1970 stated that mortgage limits should not be established below $18,000, regardless of the field offices' cost estimates for a modest house. The field offices interpreted these instructions differently, and some offices set mortgage limits on the basis of the statutory limits while other offices set them on the basis of their estimates of the selling price of a modest house. As a result, some families were able to obtain housing with options that were not available to other families.

For example, one field office estimated that the modest house would sell for about $15,100 but decided to approve houses with mortgages up to the basic statutory limits. The typical three-bedroom house approved by that office had about 1,100 square feet of improved floor area, central air conditioning, an extra bathroom, carpeting, and an average replacement cost of about $16,800.

Another field office in the same State estimated that a modest house would sell for about $15,200 and established $15,200 as the mortgage limit. The typical three-bedroom house approved by that office had about 950 square feet of improved floor area and an average replacement cost of

about $15,000. It did not have central air conditioning, carpeting, or an extra bathroom.

A field office in another State estimated that a modest house could be sold for about $15,650; however, it based the mortgage limit on the statutory limits. After the statutory mortgage limits were increased in December 1969, the average mortgage increased from about $14,350 to about $17,300 as of May 1971. The houses approved by this office often had such options as a garage, carpeting, an extra bathroom, and air conditioning. These houses, on the average, had about 160 more square feet of improved floor area than the modest house HUD described.

USDA instructions on the section 235 program state that the maximum mortgage amount will not exceed $18,000 unless approved by HUD. However, these instructions also provide that lower mortgage amounts should be encouraged in localities where suitable housing could be provided at a lower cost.

Our review indicated that USDA generally was approving section 235 houses that were comparable in cost to those being approved by HUD in the same locality. However, in one State, USDA was not making available the same housing options that HUD was. The USDA policy in this State was to provide a modest three-bedroom house of about 1,000 square feet; options were generally limited to a range and a carport. USDA set a maximum mortgage limit of $14,500, although the HUD field office used the basic statutory limit of $18,000. The houses approved under section 235 by HUD in this State during the first 6 months of 1971 had an average mortgage loan of $17,200 and often included such options as a garage, a full basement, carpeting, an extra bathroom, and air conditioning. However, the houses USDA approved during the same period had an average mortgage loan of $13,800 and were approximately 160 square feet smaller than the houses HUD approved, and options were generally limited to a range and a carport.

INCONSISTENCIES IN THE SECTION 502 PROGRAM

USDA has not established mortgage ceilings for the section 502 interest credit program. Guidelines state that houses approved for section 502 loans must be modest in size, design, and cost and that particular design features

or options should not be included if such options are customarily not included in other adequate but modest houses being built in the area by families with moderate incomes.

As a result of these rather general guidelines, county supervisors have been allowed to individually determine mortgage ceilings and housing options and housing options made available to section 502 purchasers were not consistent. For example, interest credit loans approved by a county supervisor in one State averaged about $16,000 and the houses usually contained such options as central air conditioning, a brick veneer exterior, and an extra bathroom. At the same time the average section 502 interest credit loan in another county of the same State was about $11,000 and the houses had only one bathroom, no central air conditioning, and composition siding.

INCONSISTENCIES BETWEEN THE SECTIONS 235 AND 502 PROGRAMS

Because of the differences in mortgage ceilings and design criteria established for the sections 235 and 502 programs, houses provided to low- and moderate-income families in the same locality could vary significantly. For example, in one county the houses provided under section 235 averaged about 1,120 square feet of improved area and generally had two bathrooms and central air conditioning whereas the houses provided under the section 502 interest credit program averaged about 900 square feet of improved area and had one bathroom and no central air conditioning.

EFFECT OF OPTIONS ON PROGRAM COSTS

Options included in houses approved for financing under the section 235 and section 502 subsidy programs generally result in increased cost to the Government. Options generally do not result in increased cost to the purchaser because the purchaser's payment is based on his income rather than the cost of the house.[1]

The following table shows that including $2,500 of options in a basic house costing $15,500 could increase annual subsidy costs by about $260 without increasing the purchaser's annual payment. For this table we assumed that the purchaser had an adjusted gross income of $5,100 a year and that the house was purchased subject to a 30-year mortgage bearing 7-percent interest.

	Basic house	House with options	Difference
Annual payment for principal and interest	$1,556.74	$1,815.24	$258.48
Less annual payment by purchaser (20% of adjusted income)	1,020.00	1,020.00	-
Annual payment by HUD	$ 536.76	$ 795.24	$258.48

[1]When the purchaser receives the maximum subsidy, he bears the cost of any options.

CONCLUSIONS

We believe that all eligible families should have an equal opportunity to receive the full extent of assistance intended by the Congress under the homeownership assistance programs. Because HUD and USDA guidelines have been inadequate, some families are being assisted in buying houses with options that other families in the same general area are unable to obtain.

We are not suggesting a list of options for the Nation, nor are we suggesting that purchasers be denied housing alternatives. We believe that HUD and USDA should determine what options are appropriate for houses in different areas of the country (air conditioning might be appropriate in one area and not in another) and should establish clear and uniform criteria on the basis of the estimated cost of providing houses with appropriate options in each area.

We believe that the Congress intended that HUD and USDA minimize costs consistent with the objective of providing decent, safe, and sanitary housing.

Although the Congress has established mortgage limits for the section 235 program, HUD instructions have been unclear about how the field offices should apply these limits in determining the type of housing to be provided. For the section 502 program, for which statutory mortgage ceilings have not been established, USDA has not provided its field offices with adequate guidelines to enable them to make uniform, fair decisions on housing options.

RECOMMENDATIONS

We recommend that the Secretaries of HUD and Agriculture (1) clearly define the types of housing that will be made available under homeownership assistance programs in the various areas of the Nation and (2) jointly determine what housing options are appropriate for the houses being provided in communities served by both departments.

AGENCY COMMENTS AND OUR EVALUATION

HUD, in responding to our first recommendation, referred to additional guidelines for determining mortgage limits that were issued subsequent to our review. One guideline, dated August 1971, which superseded the guideline quoted on page 35, stated that mortgage ceilings would be based on statutory limits or the estimated replacement cost plus closing cost of a moderate cost property, whichever amount was less. Another guideline, dated February 1972, revised the description of a modest house and provided that a modest house could include those features or amenities necessary to insure marketability to other than subsidized purchasers in each market area.

USDA recognized that counties varied significantly in the types of construction and the equipment being made available to low-income purchasers. USDA issued a bulletin in June 1972 which instructed State directors to reconcile differences and issue guidelines to insure a consistent application of the policy of financing adequate but modest housing.

We believe that HUD's and USDA's revised guidelines, when fully implemented, should meet the objectives of our recommendation.

HUD did not comment on our second recommendation. USDA stated that there would be little advantage in establishing a joint HUD-USDA list of housing options because HUD and USDA serve different markets. We agree that HUD and USDA generally serve different markets; however, under sections 235 and 502 programs, houses are sometimes provided in the same market area. Under these circumstances, HUD and USDA should agree on what options should be made available under both programs.

CHAPTER 5

MORTGAGE DEFAULTS

Preliminary information indicated that mortgage defaults could become a major problem in administering the section 235 program. The number of defaults on the section 502 program has been low to date; however, USDA officials anticipated that increased program activity would markedly increase the default rate. A high default rate would reduce program effectiveness and could result in significant costs to manage and dispose of acquired properties. Therefore, HUD and USDA should analyze anticipated default patterns and identify possible ways of reducing the default rate.

SECTION 235 PROGRAM DEFAULTS

We examined the default experience during the first 6 months of the program at 10 HUD field offices. As shown in the following table, the number of mortgages insured in this 6-month period and foreclosed or being foreclosed as of June 30, 1971, ranged from 2.2 percent of loans insured by the Salt Lake City, Utah, field office to 20.1 percent of loans insured by the Seattle, Washington, field office.

Foreclosures in Selected HUD Field Offices as of June 1971 For Section 235 Mortgage Loans Insured January 1 through June 30, 1969

Field office	Insured mortgage loans	Mortgages foreclosed or being foreclosed (note a)	
		Number	Percent
Columbia, S.C.	179	21	11.7
Birmingham, Ala.	143	9	6.3
Atlanta, Ga.	72	10	13.9
Dallas, Tex.	123	23	18.7
San Antonio, Tex.	128	11	8.6
Shreveport, La.	105	13	12.4
Little Rock, Ark. (note b)	-	-	-
Denver, Col.	206	8	3.9
Salt Lake City, Utah	45	1	2.2
Seattle, Wash.	179	36	20.1
Total	1,180	132	11.3

[a] Includes acquired and assigned properties and properties for which foreclosure was started but not completed.

[b] This office did not compile monthly default rates for mortgage loans insured prior to January 1, 1970. Subsequent statistics show that, of the 284 mortgage loans insured during the first quarter of 1970, 6.7 percent were foreclosed or being foreclosed.

HUD and USDA did not have separate data available on the default rate for the USDA-administered section 235 program. However, our review of defaults in one HUD field office that had insured about 26 percent of the total mortgage loans approved for insurance by USDA in fiscal years 1970 and 1971 showed that the default rates for the loans processed by USDA and those processed by HUD did not differ substantially.

At our request, HUD's actuarial staff prepared an estimate of the aggregate claim rate[1] for the section 235 program. The staff originally estimated that the claim rate for this program would be 25 percent; however, in commenting on our draft report, HUD stated that the estimate was too high. HUD said that the estimate was based on the assumption that defaults for the section 235 program would be higher than the defaults for the section 221(d)(2)[2] program which is another mortgage insurance program for low- and moderate-income families. Subsequent actuarial estimates, according to HUD, indicated that the section 235 program default rate at the end of the second program year was not as high as the default rate for the section 221(d)(2) program.

Actuarial data shows that the default rate for the section 235 program was higher than that for the section 221(d)(2) program at the end of the first year but was slightly lower by the end of the second year.

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[1]"Aggregate claim rates" are defined as the total estimated percentages of mortgages upon which mortgagees can expect to be paid insurance benefits.

[2]Since 1961 HUD has administered a mortgage insurance program authorized by section 221(d)(2) of the National Housing Act, as amended (12 U.S.C. 1715L), to assist low- and moderate-income families by encouraging homeownership with very low downpayments.

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The actuarial data on the section 221(d)(2) program shows that defaults during the first 9 years after mortgages were written reached a level of about 11 percent. A report prepared by HUD's chief actuary pointed out that it often takes 6 to 8 years to begin to obtain meaningful information about the experience risk on a mortgage insurance program. Because the default rate for the section 235 program has followed closely the default rate for the section 221(d)(2) program, we believe that section 235 defaults could reach 10 percent.

Although a precise default rate for the section 235 program has not been developed, we believe that there are sufficient indicators that the potential foreclosure rate will be high enough to warrant special efforts by HUD to reduce or avoid foreclosures.

CAUSES FOR DEFAULTS NOT DETERMINED

Although indications of a high default rate became apparent in the initial phase of the section 235 program, HUD did not analyze available data to identify possible ways of reducing defaults. Such an analysis could serve as a basis for developing criteria and guidelines for screening and counseling loan applicants to minimize defaults in the future. The analysis should include all pertinent data compiled by HUD on the section 235 program, supplemented by other information obtained through such means as interviews with mortgagors and mortgagees.

Information available to HUD includes, for example, data on (1) family characteristics of mortgagors, such as incomes, ages, and sizes of families, (2) types of properties insured, and (3) reported reasons for defaults. HUD requires mortgagees to obtain information on families defaulting and to list various reasons for the defaults, such as curtailment of incomes, excessive obligations, distant employment, or unsatisfactory conditions of the properties.

HUD generally has no direct contact with families applying for assistance under the section 235 program and relies primarily on mortgagees to screen applicants. However, in January 1972, HUD initiated a counseling program for applicants in 15 of its field offices and planned to expand the program to other field offices later.

POTENTIAL FOR LOSSES ON ACQUIRED SECTION 235 PROPERTIES

As of June 30, 1972, HUD had incurred an average loss of $3,835 per property to manage and dispose of acquired section 235 properties and a total loss of about $15.2 million. Data provided by HUD's actuaries indicates that the average loss will be even higher in the future. However, if the average loss remained the same and if the default rate reached 10 percent on the 1.4 million properties to be insured through fiscal year 1978, HUD would incur a loss of about $532 million.

USDA ANTICIPATION OF SUBSTANTIAL INCREASE IN SECTION 502 MORTGAGE DEFAULTS

USDA officials expected that the default rate of section 502 mortgage loans would increase because of increased program activity. Housing loans tripled from $500 million in fiscal year 1969 to $1.5 billion in fiscal year 1971. USDA has handled this increased activity with little or no increase in staff, which has impaired the ability of county supervisors to screen applicants and to effectively administer the program. Because of this situation, USDA officials expected that the default rate would increase substantially

As of January 1, 1969, USDA had acquired only 251 properties during the first 19 years of the basic section 502 program; in the next 3 years, it acquired an additional 1,250 properties.

The number of loan transfers is also increasing. USDA often transfers a loan in default to another eligible family rather than foreclose it. Although records at USDA headquarters did not distinguish between loan transfers made to avoid foreclosures and other loan transfers, only 1,911 loan transfers were made by assumption agreement during the first 19 years of the program whereas 1,351 loan transfers were made in the next 3 years. We were unable to obtain any nationwide information on default experience under the interest credit portion of the program.

AGENCY COMMENTS AND OUR EVALUATION

HUD, in commenting on the rate of anticipated defaults under the section 235 program, stated that a comparison (as of December 1971) of defaulted mortgages with insurance written at the field offices where we made our tests showed a significant decrease in defaulted mortgages. This rate, calculated by HUD, ranged from less than 1 percent to 12.4 percent. We believe that a comparison of total mortgage defaults with total insurance written understates the foreclosure rate because mortgages most recently insured are less likely to default and be foreclosed than mortgages outstanding for a number of years. The understatement would be particularly significant in the early stages of a rapidly expanding program, such as the section 235 program which grew from about 8,000 insured mortgages in 1968 to about 138,000 insured mortgages in 1971.

HUD informed us that it had established a continuous review of the reasons for defaults in the section 235 program. USDA stated that existing regulations provide for a case-by-case evaluation of the delinquencies and the reasons for them. However, our review indicated that both HUD and USDA procedures were not adequate to obtain a useful analysis of all significant factors related to defaults. The reasons for defaults, as shown on the mortgagees' applications for insurance claims from HUD and as categorized by USDA, are generally only the apparent after-the-fact reasons--curtailment of incomes, excessive obligations, divorces, and deaths--and do not enable HUD or USDA to identify in advance those applicants who have a high potential to default unless supplemented by further in-depth analyses of the characteristics of defaulting mortgagors and the properties on which the defaults occur.

RECOMMENDATIONS

We recommend that, to improve program effectiveness and reduce costs, the Secretaries of HUD and Agriculture require in-depth studies to determine the major reasons for defaults and what can be done to minimize foreclosures. In addition, we recommend that such studies be used as a basis for developing guidelines for screening and counseling program applicants.

CHAPTER 6

METHOD OF FINANCING

The Government could substantially save if the sections 235 and 502 housing loans were financed directly by the Government rather than by private lenders. This is possible because of the lower annual interest rate at which the Government could borrow money, compared with the interest rates in the private mortgage money market.

We estimate that savings on the section 235 program could amount to $1 billion. The savings possible on the section 502 program and on certain other loan programs were discussed in a previous GAO report.[1] In that report we stated that the Congress may wish to amend the legislation governing these loan programs to enable USDA financing through Treasury borrowings rather than through sale of borrower's loan notes.

OPPORTUNITY TO REDUCE SECTION 235 PROGRAM COSTS

HUD-approved lending institutions make loans to purchasers of houses under the section 235 program, and HUD insures that the loans will be repaid. The purchaser is required to pay at least 20 percent of his adjusted income toward the monthly payment for principal, interest, taxes, insurance, and mortgage insurance premiums. HUD pays the balance of the required monthly payment, but this subsidy shall not reduce the purchaser's obligation below the amount required if the mortgage bore interest at the rate of 1 percent.

The amount of assistance payments therefore depends on the mortgage interest rate. For example, the maximum annual assistance payment for an $18,000, 30-year, 8-percent mortgage would be about $979; whereas the maximum annual

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[1]Report to the Congress, "Legislation Recommended to Reduce Losses of Two Insured Funds of the Farmers Home Administration" (B-114873, July 20, 1971).

assistance would be about $831 if the mortgage had a 7-percent interest rate.

If the subsidized loans made under the section 235 program were financed with Treasury borrowings rather than by private lenders, the Government could take advantage of its ability to borrow funds at lower interest rates than those charged by private lenders. Data compiled by the Federal National Mortgage Association shows that the interest yield on home mortgage loans insured by HUD was 7.62 percent in August 1972. The interest yield on a recent issuance of long-term Treasury bonds ($2.3 billion, Aug. 15, 1972) was 6.5 percent.

On the basis of information in the President's "Second Annual Report on National Housing Goals," dated April 1970, we calculated that loans for new and rehabilitated houses planned to be provided under the section 235 program during fiscal years 1973 through 1978 will amount to about $19.7 billion. If these loans were made with Treasury borrowings and if the purchasers received assistance payments for an average of 13 years, the present value of the savings to the Government would amount to approximately $1 billion.[1]

We used the present-value method to estimate savings because we believe this is the most appropriate method of estimating long-range costs. Under the present-value method, the current values of fund flows over a specific period of time are calculated by use of a discount rate. The discounting of future costs makes them comparable to present costs, i.e., to the present value of costs. The 6.5-percent yield on a recent issuance of long-term Government bonds in August 1972 was used as the discount rate.

Our estimate considered (1) Federal tax revenues on income to investors in Government securities, (2) costs

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[1]This estimate was based on the 1.05 million new and substantially rehabilitated houses planned to be provided under the section 235 program during fiscal years 1973 through 1978. We could not estimate savings on loans for existing houses because under the section 235 program HUD had not forecast the units planned for financing.

incurred by the Government under the "tandem plan"--a plan under which the Government National Mortgage Association and the Federal National Mortgage Association provide joint financial assistance in financing section 235 mortgages--and (3) costs of servicing mortgage loans under a Government direct loan program.

LOAN PROCESSING AND SERVICING

Under HUD's mortgage loan insurance programs, private lending institutions process the loan applications and service mortgage loans. Our inquiries indicated that most private lending institutions involved in the section 235 program would be willing to process loan applications and service mortgage loans for loans financed through Treasury borrowings for the same fees that they presently receive for these services.

Private lending institutions generally require fees of at least 1 percent of the mortgage loan amounts to cover costs of processing mortgage loans. After the loans are made, the lending institutions service the loans, which includes accounting for receipts and payments of real estate taxes and insurance.

The lending institutions that make the original loans sometimes sell the mortgage loans to other investors but continue to service the loans. When this is done, the purchasers of the mortgage loans generally pay annual fees of three-eighths of 1 percent of the unpaid principals for these services. Also, the lending institutions are required to do other special loan servicing, including monthly calculations of assistance payments due from HUD, for which they are paid a monthly fee of $3.50 for each section 235 mortgage loan held.

The president of the Mortgage Bankers Association of America and the vice president-controller of the Government National Mortgage Association advised us that most lending institutions involved in the section 235 program sold the mortgage loans to other investors and that, in their opinion, the lending institutions making the original loans were interested primarily in the mortgage loan processing and servicing fees. They concluded that most lending institutions involved in the section 235 program would be willing

to process and service the mortgage loans for a federally financed loan program for the same fee that they presently receive for these services.

CONCLUSIONS

Costs of the section 235 program could be substantially reduced if HUD were authorized to make loans to eligible families with Treasury borrowings. The savings could be realized without significantly disrupting the relationship between HUD and the lending institutions.

We recognize that cost is not the only factor to consider in determining which method of financing is most appropriate for a particular program. However, we believe that the Congress should be made aware of the costs that could be saved as a result of an alternative method of financing the section 235 program.

AGENCY COMMENTS AND OUR EVALUATION

HUD, the Department of the Treasury, and the Office of Management and Budget (OMB), although recognizing that the Treasury could borrow at lower interest rates than available in the private mortgage money market, made certain observations on behalf of the present method of financing. Their comments are presented in appendixes III, IV, and V and are summarized below.

HUD

HUD suggested that direct Federal financing of section 235 loans might increase the interest cost of Government borrowings. However, a Treasury official advised us that the increase in Treasury borrowings would not appreciably increase the cost of Government borrowings.

HUD stated that the cost of direct Federal financing might equal or exceed the cost under the present method because of the need for refinancing the public debt. Our estimate of savings is based on the assumption that funds would be obtained through long-term Treasury borrowings; therefore, refinancing should not be necessary.

HUD stated that substantial staff increases would be required to process loan applications and to establish and maintain accounting records and reports. Our review indicated that most mortgagees involved in the section 235 program would be willing to perform these services for HUD at no increase in cost over the present method. In these circumstances, substantial staff increases would not be needed.

HUD commented on the fact that direct Federal financing of the section 235 program would result in a larger Federal budget and increased cash flow from the Treasury. HUD estimated the amount to be about $3.5 billion for fiscal year 1973. We agree that the budget for the section 235 program would have to be increased and that direct Federal financing would initially increase cash flows from the Treasury. However, this would be true only during the early years because loans would be repaid together with interest in later years. Because of the more favorable interest rates for Government borrowing, the direct loan method could reduce costs to the Government without increasing costs to the purchasers.

Treasury

Treasury agreed that the present-value method was appropriate for this analysis but stated that enactment of legislation proposed by it in December 1971, which would create a Federal bank to finance Government loan guarantee programs, would substantially achieve the objective of our proposal. The Congress did not enact this legislation.

OMB

OMB, like HUD, commented on the fact that direct Federal financing of the section 235 program would require a larger Federal budget. In addition, OMB expressed the view that the Government should not seek a major role as a direct lender when the private economy can perform this function effectively. We believe that this is a policy question to be considered by the Congress in determining whether to approve direct Federal financing of the section 235 program.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Because of the potential interest savings, we recommend that the Congress consider legislation which would permit section 235 loans to be financed by the Government rather than by private lenders. We have previously recommended that the Congress consider amending the legislation pertaining to the section 502 program to require direct Federal financing.

CHAPTER 7

HUD AND USDA INTERNAL AUDIT REVIEWS

OF HOMEOWNERSHIP ASSISTANCE PROGRAMS

OIG and HUD's Office of Audit have reviewed several important aspects of the administration of the sections 235 and 502 programs. Their audit reports, issued in fiscal years 1971 and 1972, pointed out significant weaknesses and the need for improvements.

HUD's and USDA's internal audit findings on physical defects of housing provided under the programs are presented in chapter 3. Certain other aspects of program administration and the corrective actions taken or planned by HUD and USDA in response to their auditors' recommendations are summarized in this chapter. We are bringing these matters to the attention of the Congress because they indicate that the departments are cognizant of major problems in the programs and are seeking ways to overcome these problems.

HUD AUDIT FINDINGS

HUD's Office of Audit reported in December 1971 that under the section 235 program (1) a number of families received assistance to which they were not entitled because procedures to insure their eligibility for assistance were inadequate and (2) actions in response to mortgagors' complaints were deficient and showed a need for greater emphasis on consumer protection.

Eligibility of families for assistance

HUD relied on the mortgagees to determine the annual incomes of families and to calculate the amounts of assistance families would receive. However, HUD's Office of Audit found that:

1. HUD's guidelines for determining family incomes by mortgagees were inadequate.

2. Field offices were not required to make test reviews of mortgagees' operations but instead relied on the Office of Audit's reviews to determine whether

mortgagees were complying with applicable regulations and requirements.

3. Mortgagees were not required to verify reported family incomes used to determine eligibility for assistance.

4. HUD did not maintain records of the amount of assistance provided to each family.

5. Mortgagees were not required to verify either family size or family assets, both of which are used in determining eligibility for and amount of assistance.

Handling of mortgagors' complaints

HUD's Office of Audit reported that the policies and procedures for handling mortgagors' complaints about the conditions of existing housing were deficient and that, although the prescribed procedures on new housing were generally adequate, field offices needed to better implement them. The auditors found that many legitimate complaints made by buyers of existing housing were not resolved promptly, if at all.

HUD's Office of Audit concluded that consumer protection should be emphasized more and made several suggestions for accomplishing this.

--Provide the buyer of an existing house with a list of all repairs and improvements HUD requires the seller to make.

--Provide for standard sales contracts and settlement forms.

--Provide the buyer with a brochure containing information on such matters as homeownership costs, problems, and responsibilities; routine maintenance requirements; and procedures for filing complaints with HUD.

--Inform the buyer of HUD's limited responsibility for the condition of the house.

--Consider alternatives to the present counseling program, such as including fees in mortgage amounts to compensate appropriate organizations for counseling and assisting unsophisticated buyers.

Corrective actions taken and planned

HUD has issued revised procedures requiring the annual, rather than biannual, recertification of a purchaser's occupancy, employment, income, and family composition. These procedures require the homeowner to immediately report significant changes in status and provide for suspension, rather than termination, of assistance payments to a family whose income rises above the prescribed limits.

For better consumer protection, HUD took, or planned to take, a number of actions, including:

--Improving procedures for more effectively handling mortgagors' complaints on existing housing.

--Revising instructions to require that purchasers be informed of HUD's limited responsibilities for insuring the properties involved and of all repairs and/or improvements which HUD requires the sellers to make as a precondition to issuance of mortgage insurance.

--Developing standard sales contracts and settlement forms.

--Developing a "Homeownership Preparedness" booklet dealing with money management, property purchase procedures, property care and maintenance, and other pertinent subjects.

--Planning a public education campaign through the news media to provide consumers with information on homeownership problems and responsibilities.

--Initiating a counseling program in 15 field offices using authorized organizations to provide counseling to certain families.

USDA AUDIT FINDINGS

In August 1971 OIG commented on the need for (1) organizational changes in rural housing programs, (2) more technically trained staff, (3) strengthened guidelines covering eligibility requirements, and (4) certain other program improvements.

Need for organizational changes

OIG reported that the organization of FHA did not provide an effective system for routinely informing USDA headquarters of FHA field offices' compliance with policy directives, adherence to procedures, and accomplishment of program objectives. As a result, USDA headquarters was neither exercising effective control over State and county office operations nor receiving adequate feedback on program administration and accomplishments.

OIG noted that the FHA Administrator supervised 42 State directors in addition to his immediate staff and that the Administrator's staff advised the State directors and their staffs but did not exercise line authority over State and county office operations. OIG concluded that, considering the nature and extent of program irregularities uncovered by its audits, FHA should be reorganized to provide effective line authority over State and county office operations and should adopt a system of controls to routinely provide the Administrator and his staff with current and reliable information on field operations.

Also, OIG reported that USDA headquarters was not adequately monitoring field operations nor receiving adequate information on field operations through existing reporting procedures. It recommended that USDA develop and use a system of review of program operations from which it could obtain qualitative data to evaluate the accomplishment of program objectives.

Need for more technically trained staff

OIG reported that USDA needed more engineers, architects, sanitarians, community planners, and construction specialists to provide the technical skills required for effective administration of the housing program. OIG found

an imbalance between the areas of expertise of the present staff and the funding levels of the programs.

OIG concluded that, on the basis of the funding of the loan programs, the number and technical capabilities of the professional staff, and the nature and extent of deficiencies disclosed by its audit and investigations, USDA should expand its staff both in numbers and technical capabilities, to strengthen program administration.

OIG also proposed adopting a career development plan for employees and initiating an intensified, continuous training curriculum provided by staff specialists.

Eligibility of families for assistance

OIG noted that in some areas the housing needs of lower income rural families were not being adequately served while middle-income families were receiving loans in conflict with program objectives and legislative intent.

OIG found that 1,424 of about 10,270 loans examined, or nearly 14 percent, either were made to ineligible borrowers or were made on houses in or near urban centers which exceeded the population limitations and/or other eligibility criteria. OIG reported that USDA needed to strengthen guidelines and instructions covering eligibility requirements.

Subdivision planning and development

OIG reported that USDA should strengthen its guidelines and instructions on planning and developing subdivisions financed with rural housing loans. Major problems found by OIG in the USDA-financed subdivisions were:

1. Some subdivisions were close to urban areas.

2. Water supply systems failed to comply with State regulations and/or failed to meet minimum standards recommended by the State departments of health and the U.S. Public Health Service.

3. Individual septic and/or community sewage disposal systems were inadequate in size, design, or treatment facilities.

4. Road development was inadequate.

On the basis of its findings, OIG concluded that USDA was making rural housing loans in nonrural areas and was financing subdivisions with the potential to develop serious health hazards.

Corrective actions taken and planned

USDA has reorganized the FHA headquarters to accomplish the major objective of the OIG recommendations; i.e., to provide FHA headquarters with more effective authority and control over State and county office operations. Also, USDA has taken a number of actions to increase monitoring of State and county office operations and to provide headquarters with the feedback necessary to adequately administer the housing programs.

A USDA official stated that budget constraints limit the extent to which USDA is able to expand its field offices' technical staffs; however, as noted on page 31, some State and county offices have hired or plan to hire additional technical staff. In addition, USDA has tried, through increased and better training programs, to more effectively use its present staffs.

USDA, in November 1972, was issuing instructions on subdivision planning and development. The instructions will include design and construction standards for water and sewage systems, street improvements, and storm drainage and will require prior approval of proposed subdivisions by the State and/or headquarters office under certain circumstances.

HUD ESTIMATES OF HOUSING NEEDS AND UNITS PROVIDED

UNDER THE SECTIONS 235 AND 236 PROGRAMS

AUGUST 1968 THROUGH DECEMBER 1971

State	Total population ranking	Estimates of needs (note a)		Housing units provided					
				Total		Section 235		Section 236	
		Units	Rank	Units	Rank	Units	Rank	Units	Rank
Northeast:									
Connecticut	24	9,915	21	7,512	25	609	42	6,903	11
Maine	38	3,480	38	1,257	46	502	45	755	41
Massachusetts	10	25,245	8	9,957	16	2,279	33	7,678	9
New Hampshire	42	2,760	41	2,097	40	824	40	1,273	35
New Jersey	8	25,980	7	4,815	32	2,460	31	2,355	27
New York	2	110,770	1	11,855	13	2,633	30	9,222	6
Pennsylvania	3	39,440	4	11,750	14	3,700	27	8,050	7
Rhode Island	39	3,590	37	1,528	44	439	48	1,089	38
Vermont	49	1,205	47	577	50	245	50	332	47
Total		222,385		51,348		13,691		37, 657	
South:									
Alabama	21	11,170	17	9,653	17	8,346	12	1,307	34
Arkansas	32	5,345	32	5,504	31	4,181	24	1,323	33
Delaware	47	1,405	46	382	51	229	51	153	51
District of Columbia	41	11,850	16	2,808	39	599	43	2,209	28
Florida	9	24,930	9	25,925	4	18,301	2	7,624	10
Georgia	15	13,345	14	18,970	6	13,841	5	5,129	14
Kentucky	23	6,955	27	8,712	19	5,333	18	3,379	19
Louisiana	20	10,905	20	18,083	8	14,551	4	3,532	18
Maryland	18	8,010	24	6,948	26	790	41	6,158	13
Mississippi	29	4,960	34	8,130	22	6,918	13	1,212	37
North Carolina	12	13,130	15	8,145	21	5,098	19	3,047	20
Oklahoma	27	7,785	25	10,759	15	6,840	14	3,919	16
South Carolina	26	6,980	26	13,924	11	11,407	7	2,517	24
Tennessee	17	10,955	18	13,308	12	10,847	8	2,461	26
Texas	4	33,025	6	45,265	1	25,456	1	19,809	2
Virginia	14	8,280	23	8,895	18	2,414	32	6,481	12
West Virginia	34	3,835	36	1,261	45	599	44	662	43
Total		182,865		206,672		135,750		70,922	
North Central:									
Illinois	5	44,935	3	18,798	7	10,813	9	7,985	8
Indiana	11	14,130	11	15,102	9	5,686	16	9,416	5
Iowa	25	5,060	33	7,566	23	4,740	20	2,826	22
Kansas	28	6,865	28	4,437	35	2,242	34	2,195	29
Michigan	7	20,680	10	26,934	3	13,830	6	13,104	4
Minnesota	19	8,625	22	5,762	30	2,017	35	3,745	17
Missouri	13	13,770	12	6,772	27	3,775	26	2,997	21
Nebraska	35	4,065	35	4,215	37	2,960	29	1,255	36
North Dakota	46	1,635	44	768	47	442	47	326	48
Ohio	6	36,540	5	22,999	5	9,651	11	13,348	3
South Dakota	45	1,130	49	3,431	38	914	39	2,517	25
Wisconsin	16	13,725	13	7,562	24	5,400	17	2,162	31
Total		171,160		124,346		62,470		61,876	
West:									
Alaska	51	1,095	50	692	48	280	49	412	46
Arizona	33	6,060	31	6,650	28	4,461	22	2,189	30
California	1	72,285	2	41,172	2	18,111	3	23,061	1
Colorado	30	6,760	29	8,382	20	5,687	15	2,695	23
Hawaii	40	2,685	42	1,754	42	1,058	37	696	42
Idaho	43	1,410	45	1,845	41	1,361	36	484	45
Montana	44	1,810	43	1,620	43	998	38	622	44
Nevada	48	1,175	48	4,708	34	3,810	25	898	40
New Mexico	37	2,895	39	4,283	36	3,380	28	903	39
Oregon	31	6,686	30	5,817	29	4,341	23	1,476	32
Utah	36	2,860	40	4,764	33	4,565	21	199	49
Washington	22	10,929	19	14,130	10	9,839	10	4,291	15
Wyoming	30	850	51	670	49	488	46	182	50
Total		117,500		96,487		58,379		38,108	
U.S. total		693,910		478,853		270,290		208,563	

[a]These estimates based on data furnished by HUD headquarters, represent the needs for units which could be sold in a 3-year period.

APPENDIX II

HOUSING PROVIDED UNDER USDA'S SECTION 502 PROGRAM

AUGUST 1968 THROUGH DECEMBER 1971

State	Rural population ranking	Housing units provided: Total Units	Total Rank	Interest credit program Units	Interest credit program Rank	Other loans (note a) Units	Other loans (note a) Rank
Northeast:							
Connecticut	32	675	45	160	46	515	44
Maine	34	5,175	19	2,185	12	2,990	23
Massachusetts	27	552	47	290	42	262	47
New Hampshire	41	1,157	41	533	33	624	43
New Jersey	29	2,970	30	393	36	2,577	26
New York	3	6,185	16	1,198	22	4,987	15
Pennsylvania	1	4,101	23	695	27	3,406	21
Rhode Island	49	194	50	76	48	118	50
Vermont	43	2,032	35	530	34	1,502	34
Total		23,041		6,060		16,981	
South:							
Alabama	15	12,288	6	4,719	5	7,569	5
Arkansas	24	12,837	5	5,302	3	7,535	6
Delaware	46	720	44	211	45	509	45
District of Columbia	51		51		51		51
Florida	18	4,042	24	1,669	16	2,373	27
Georgia	9	11,243	7	3,948	6	7,295	7
Kentucky	13	7,729	11	1,782	14	5,947	10
Louisiana	20	4,112	22	1,153	24	2,959	24
Maryland	26	2,608	32	378	38	2,230	29
Mississippi	21	15,616	2	5,849	2	9,767	2
North Carolina	2	15,956	1	4,918	4	11,038	1
Oklahoma	28	7,427	13	1,500	18	5,927	11
South Carolina	17	14,318	3	7,974	1	6,344	9
Tennessee	12	10,544	8	2,613	10	7,931	4
Texas	6	13,357	4	3,790	7	9,567	3
Virginia	11	8,248	10	2,630	9	5,618	13
West Virginia	23	4,911	21	677	29	4,234	20
Total		145,952		49,109		96,843	
North Central:							
Illinois	7	4,949	20	599	30	4,350	19
Indiana	8	7,701	12	1,883	13	5,818	12
Iowa	22	5,316	18	687	28	5,629	17
Kansas	30	2,879	31	538	32	2,341	28
Michigan	5	6,748	14	1,553	17	5,195	14
Minnesota	19	3,569	27	547	31	3,022	22
Missouri	16	10,170	9	3,758	8	6,412	8
Nebraska	33	2,056	34	342	39	1,714	32
North Dakota	38	2,357	33	761	26	1,596	33
Ohio	4	5,924	17	1,358	20	4,566	18
South Dakota	36	1,766	38	327	40	1,439	36
Wisconsin	14	6,404	15	1,478	19	1,926	16
Total		59,839		13,831		46,008	
West:							
Alaska	45	284	48	32	50	252	48
Arizona	37	3,550	28	1,751	15	1,799	31
California	10	3,767	26	2,463	11	1,304	37
Colorado	35	1,485	39	391	37	1,094	38
Hawaii	48	941	43	242	43	699	42
Idaho	39	3,275	29	1,158	23	2,117	30
Montana	40	600	46	130	47	470	46
Nevada	50	219	49	68	49	151	49
New Mexico	42	1,183	40	308	41	875	41
Oregon	31	1,950	36	1,031	25	919	39
Utah	44	1,920	37	446	35	1,474	35
Washington	25	3,815	25	1,235	21	2,580	25
Wyoming	47	1,130	42	224	44	906	40
Total		24,119		9,479		14,640	
U.S. total		252,951		78,479		174,472	

[a]Includes housing units provided in July 1968.

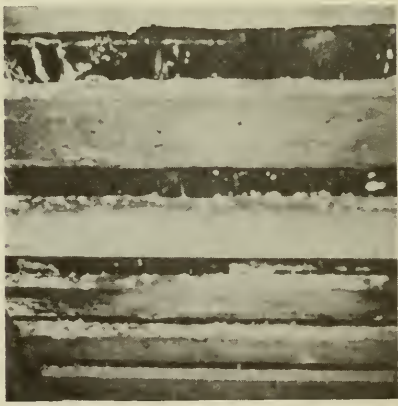
PHOTOGRAPHS SHOWING EXAMPLES OF DEFECTS IN HOUSES PROVIDED BY HUD AND USDA UNDER THE SECTION 235 AND 502 PROGRAMS

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Unsafe fuse box, with exposed wiring, located in kitchen. Seattle. Washington.

Inoperable bathroom sink blocking a portion of window. Seattle, Washington.

Defective electrical wiring between fuse boxes. Seattle, Washington.



Rafters rotting as a result of leak in roof. Seattle, Washington.

APPENDIX III

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Uncapped gasline with shutoff valve which could be easily opened by small children. Commerce City, Colorado.

Structural defect--brick wall cracked both below and above window. Washington, D.C.

Paint peeling on kitchen walls and exposed pipes. Washington, D.C.

Cracked and dilapidated exterior door. Washington, D.C.

APPENDIX III

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Plaster cracked and separating from bathroom wall. Washington, D.C.

Broken and missing floor tiles in kitchen. Washington D.C.

Damage to first-floor ceiling resulting from defective plumbing. Alexandria, Virginia.

Badly weathered wood siding with metal patches and clothes-washing machine installed outdoors. Garland, Texas.

APPENDIX III

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Uncovered area between first floor and basement with exposed electrical wiring. Chehalis, Washington.

Safety hazard--dilapidated and rotting steps. McCleary, Washington.

Dilapidated porch, lack of gutters, and warped door. Montesano, Washington.

Safety hazard--substandard electrical fixture. Roof leaking around chimney. McCleary, Washington.

DEFECTS IN NEW HOUSES PROVIDED BY HUD

Improper grading resulted in water draining into crawl space; at time of inspection 6 inches of water were under this house. Lynwood, Washington.

Fire hazard—opening in closet ceiling around flue should have been fireproofed. Colorado Springs, Colorado.

Structural defect—large crack in front of house caused by improper foundation. Mesquite, Texas.

Interior flooring of house shown in photograph to the left. Mesquite, Texas.

APPENDIX III

DEFECTS IN NEW HOUSES PROVIDED BY USDA

No finished flooring material installed over subfloor. Hole in bedroom floor through which rodents could enter, Redmond, Washington.

Improper grading resulting in water ponding. Marysville, Washington.

Water heater located in attic without pressure release valve connected to outside and no device to handle water overflow. Marysville, Washington.

Improper grading resulting in inadequate drainage, Marysville, Washington.

APPENDIX IV

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FEDERAL HOUSING ADMINISTRATION
WASHINGTON, D. C. 20411

JUL 17 1972

ASSISTANT SECRETARY-COMMISSIONER

Mr. B. E. Birkle
Associate Director
United States General Accounting Office
Washington, D. C. 20548

Dear Mr. Birkle:

In responding to your letter of April 27, 1972, transmitting to the Secretary copies of your draft report on "Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs", I wish to express our gratitude for the time and constructive attention that your staff has given to the difficult and important subject. Comment is offered below with particular reference to the specific recommendations that have been tentatively stated.

Recommendation 1. - The report recommends that the Secretary of HUD and the Secretary of USDA provide a more equitable distribution of program resources.

On October 13, 1971, in testimony before the Legal and Monetary Affairs Subcommittee of the Committee on Government Operations, House of Representatives, I stated that, as with all the annual housing subsidy authorizations, Section 235 allocations are determined by a formula which contains four parts as follows:

1. Past production, which is measured in terms of comparable dwelling units started in similar programs in the various jurisdictions during the past year.

2. Need for subsidized housing, which is measured in terms of households within each jurisdiction and eligible for assistance in the program. Current needs are estimated by HUD in the Central Office by updating 1960 census data. This series on needs reflects in annual terms the 10-year goal of eliminating substandard housing and is given double weighting in the calculation of the composite percentages.

3. Next year's expected starts, which are estimated by HUD field office directors of the number of units that the industry will start during the next calendar year within each jurisdiction.

APPENDIX IV

4. Market absorption capacity for additional subsidized housing, which is based upon HUD field office directors' estimates of the maximum number of additional units that would be occupied by eligible families within a coming 12-month period if there were no limitations on the number of additional units to be made available.

Need and market-absorption potential are weighted heavily (60%/40%) in relation to past and projected starts. The figures which the Central Office arrive at are reviewed at the Regional and Field Office levels and returned to the Central Office for final adjustment before allocations are made. Moreover, Project Selection Criteria, which govern distribution of contract authority at the field office level in the interest of equal opportunity will weigh heavily in determining the need for subsidized housing in any particular area in the future.

We do agree that the field offices should take a more active role, working with State and local governments, in determining areas of greatest need for subsidized housing, and that priority should be given to the development of these areas. Your report refers to the high need for low and moderate income housing in the northeast and the apparent shortage of housing to meet this need. It should be realized that contributing to this housing shortage are statutory mortgage limitations, restrictive income limits, increasing land costs and taxes and the conservative attitudes of some banking institutions. Passage of the proposed Housing and Simplification Act, which would permit the Secretary to administratively determine mortgage limits and income limits, would improve this situation.

Recommendation 2. - The report recommends that the Secretaries of HUD and USDA require that all houses be re-inspected within one year after purchase to assure that defects covered by builder service policies and seller certifications have been identified and corrected.

We agree in theory with this recommendation. However, the problems of fact finding and judgment necessary to distinguish between initial construction defects and poor maintenance are indeed difficult and time-consuming as has been amply demonstrated by the Section 518(b) claims being processed. Thus, without proper staffing, the reinspection of houses within a year after purchase would add another burden and further deteriorate our service. Inasmuch as our budget will not cover the addition of staff for this purpose, our only hope of accomplishing this work, if it were required in the near future, would be by use of private fee inspectors.

We are preparing consumer information that will fully explain what recourse the mortgagor has in having legitimate repairs made, and the channels he must use to secure such repairs.

Recommendation 3. - The report recommends that the Secretaries of HUD and USDA require their agencies to jointly determine what amenity options are appropriate for inclusion in houses being provided in various areas of the Nation and to establish mortgage limits that reflect the estimated cost of providing houses with the appropriate options.

We believe current guidelines for determining mortgage limits and amenities are adequate. These, of course, include guidelines issued after the period covered by your report.

Circular HPMC-FHA 4400.43 dated August 31, 1971, Limitations on Utilization of Basic Statutory Limits for Section 235(i) and 237, states in reference to mortgage limits and amenities:

> "The moderate cost property developed under these procedures is not to be considered a prototype for actual housing in the area. It is rather to be a hypothetical property used to establish mortgage limits. Within these mortgage limits, builders are free to develop housing with whatever amenities they feel necessary to meet the competitive market."

Handbook HPMC-FHA 4441.1A, Homeownership for Lower Income Families Section 235, Paragraph 10 (September 1971) states the need for Directors to establish mortgage limits below the statutory maximums; and Circular HPMC 4000.10, issued February 2, 1972, provides for the addition of certain features to the moderate-cost house used as a basis for establishing mortgage limits.

Recommendation 4. - The report recommends that the Secretaries of HUD and USDA require that in-depth studies be made to determine the major reasons for defaults and what can be done to minimize the default rate. In addition, the report recommends that such studies be used as a basis for developing guidelines for screening and counseling applicants.

On page 56[1] of the report, the statement is made that HUD's actuarial staff has estimated an aggregate foreclosure rate of 25 percent for the Section 235 program. This estimate was made prior to the development of any actuarial data on the Section 235 program. As I believe was explained to the auditors by the actuarial staff at that time, the estimate of 25 percent was based upon the assumption that the program would sustain greater losses than Section 221(d)(2) and it included allowance for the possible occurrence of a major economic depression. Since that estimate was made, actuarial data on the 235 program have been received through calendar year 1971; the data indicate that the program is not sustaining as heavy a foreclosure rate as the Section 221(d)(2) program and that the estimate of 25 percent is much too high. The national average for actual foreclosures (conveyed titles and assignments later foreclosed) as of December 31, 1971, was 1.6 percent. In addition, a comparison (as of

[1]GAO note: This page number refers to our draft report.

December 31, 1971) of the offices referred to in your report illustrates a significant decrease in defaulted mortgages, as shown in the table on this page.

The publicity given the foreclosure rate and associated problems in central-city areas of several metropolitan areas do represent very real and very vexing problems, but should not be allowed to distort our impression of the over-all experience in the low-cost subsidy programs.

We have established a procedure for a continuous review of the reasons for defaults in the Section 235 program. The reason for default is included by the mortgagee on the application for insurance claim. Our analysis of this information will not only provide data on the reasons for default but will assist the Department in developing an early-warning system designed to cure defaults and avert foreclosure or assignment.

Insurance Written & Defaults for Section 235 as of December 31, 1971

	Insurance Written	1/ Defaulted Mortgages	Percent of Mortgages Defaulted
Columbia	11406	901	7.9
	2/(179)	(21)	(11.7)
Birmingham	8349	270	3.2
	(143)	(9)	(6.3)
Atlanta	13440	592	4.4
	(72)	(10)	(13.9)
Dallas	9284	480	5.2
	(123)	(23)	(18.7)
San Antonio	7734	326	4.2
	(128)	(11)	(8.6)
Shreveport	5927	217	3.6
	(105)	(13)	(12.4)
3/Little Rock	4403	161	3.6
Denver	5691	90	1.6
	(206)	(8)	(3.9)
Salt Lake City	4574	31	.6
	(45)	(1)	(2.2)
Seattle	7438	922	12.4
	(179)	(36)	(20.1)

1/ Includes mortgages which were foreclosed by the mortgagee and title transferred to HUD, mortgages which were assigned to HUD, and mortgages which were in the process of foreclosure.

2/ ( ) figures expressed in GAO Report concerning default experience for mortgages insured during period from January 1, 1969 through June 30, 1969.

3/ Monthly default rates were not compiled for mortgage loans insured prior to January 1, 1970. However, 6.1 percent of the 284 mortgage loans insured during first quarter of 1970 were foreclosed or in foreclosure.

APPENDIX IV

Recommendation 5. - The report recommends that the Congress consider amending the legislation pertaining to the Section 235 Homeownership Assistance program to require that the loans be financed by borrowings from the Treasury.

Whether or not it is in the public interest for HUD to enter the mortgage-banking business is a rather broad and basic question. If it is to be further pursued, I assume that the Office of Management and Budget will coordinate recommendations from the Executive Branch. My response at the moment, therefore, is merely to pass along to you some of the factors that we would believe to require careful consideration.

Financing the 235 mortgage out of Treasury borrowings, as proposed, at an interest rate of 5.62%, the government borrowing rate, rather than the current 7.62% private rate, could conceivably save money. Presumably, the subsidy would be paid in a smaller amount and for a shorter period.

If this plan were in effect, however, the demand for government borrowings would increase and the government cost of borrowing might well increase. Simultaneously, the demand for market rate mortgages could be expected to decrease. This probably would be followed by a decline in market interest rates. For HUD to finance Section 235 mortgages directly would involve cash outlays for the entire mortgage amount rather than for the monthly subsidy. The budgetary requirements would be greater in the short run to maintain similar production levels.

[See GAO note, p. 73.]

In any event, the recommendation for financing Section 235 mortgages through the Treasury would require a very substantial budget outlay annually. For example, the 1973 budgeted level of 198,000 units, multiplied by an average mortgage amount of $18,040, would require a cash flow from the Treasury of $3,571,920,000 in one fiscal year. In addition to the initial outlay, there would be an interest subsidy which would be less than the current subsidy of approximately $76.00 per month per

APPENDIX IV

family unit insured under the program. Secondly, processing of applications (now handled by mortgagees for one percent placement fee paid by the buyer or seller under the 235 program), would have to be assumed by HUD, requiring either a substantial increase in manpower or processing of applications on a contractual basis would require a fee. With government refinancing of the public debt, it is entirely possible that this method of financing might result, over the long term, in costs equaling or exceeding the present method of financing home mortgages under the Section 235 program.

[See GAO note, p. 73.]

The proposal does not indicate the intended tax status of Treasury borrowings for this purpose. If such borrowings were to be on the basis of tax-exempt notes, the loss of revenue in the form of interest income from the purchasers of the notes would be a factor for consideration in determining the over-all cost of the loan program.

It is further pointed out that accounting records would have to be established and maintained to show the status of mortgage loan balances. Monthly remittances from servicers covering the portions of mortgage payments collected from mortgagors would have to be supported by details to show the computation of both the mortgagor's share and the subsidy payment for each mortgage. This information would be necessary in order to make the transfer of the subsidy payment from the Section 235 Appropriation Account to the Treasury Borrowing Account. Substantial manpower would be required to perform this work.

[See GAO note, p. 73.]

This proposal obviously is one having many ramifications and requiring very careful consideration. We shall expect to study the matter further, if called upon to do so.

In conclusion, it would appear that, with continuing experience in subsidized single-family housing and additional manpower especially in the field, a more refined method of distribution will evolve along with improved administration of the program.

Sincerely,

Eugene A. Gulledge

GAO note: Several statements in HUD's reply were discussed with HUD officials and, with their concurrence, have been deleted.

APPENDIX V

UNITED STATES DEPARTMENT OF AGRICULTURE
FARMERS HOME ADMINISTRATION
WASHINGTON, D.C. 20250

OFFICE OF THE ADMINISTRATOR

Mr. Max Hirschhorn
Deputy Director
Resources and Economic Development Division
United States General Accounting Office
Washington, D. C. 20548

JUL 3 1972

Dear Mr. Hirschhorn:

This is in response to your request for our comments on the draft GAO report on "Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs of HUD and USDA." Our comments on the recommendations are:

1. The allocation of rural housing funds made to states takes into consideration factors such as number of rural homes, condition of homes, income of rural families, average cost of new homes, and historical lending patterns. Our evaluation is that we are distributing the funds to states in accordance with need. Although no separate allocation is made for interest credit loans, the states will be instructed to channel at least 50 percent of the allocation of rural housing section 502 funds into housing for low-income families.

2. Should the congressional appropriation permit, we intend to put into effect a requirement that all houses be inspected during the eleventh month of the 1-year warranty period to determine whether any defects exist which may be covered by the warranty.

3. Under law we can finance only homes for low- and moderate-income families that are modest in size, design and cost. Our regulations provide that they will include only those features that are customarily included in modest homes in the area financed by other lenders for moderate-income families. This policy has produced adequate but modest homes for low-income families at reasonable costs. To specify, a list of options and established cost limits would complicate operations and not assure better performance. Since HUD and FmHA serve different markets, there would be little advantage to establishing joint lists of options and mortgage limits. Where significant differences exist among counties within a state, administrative action will be taken to secure uniformity.

4. The Farmers Home Administration has a regulation, "Special Servicing of Delinquent and Other Problem FHA Loans to Individuals" (FHA Instruction 460.1), which provides for a case-by-case evaluation of delinquencies. The borrower's financial position and the status of his loan account are analyzed and the reasons for delinquency determined. It has been found that they generally fall in the following categories: economic conditions, divorce, extended illness, and death. Servicing action is on an individual case basis. We also intend to increase our staff at the National level so that we will be able to give proper direction to and make appropriate studies of account and property servicing.

5. The recommendations that a buyer of used housing has recourse to the seller to cover the cost of repairing defects that exist at the time of sale will be studied.

In view of the previous data submitted and our discussion, there is need to update some of the information in the report. This is particularly true of the references to the earlier OIG report.

[See GAO note.]

Sincerely,

JAMES V. SMITH
Administrator

Attachment

GAO note: Appropriate changes have been made in the final report to recognize the deleted matters.

89-901 O - 73 - 9

APPENDIX VI

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

June 7, 1972

Dear Mr. McAuley:

This is in reply to your letter of April 28, 1972 to Secretary Connally requesting comments on Chapter 6 of your draft report, "Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs -- Department of Housing and Urban Development and Department of Agriculture."

Draft Chapter 6 concludes that costs to the Federal Government under the section 235 homeownership assistance program could be substantially reduced if HUD were authorized to make loans to eligible families with funds borrowed by the Treasury, rather than the existing method of financing the program by insured loans made by private lenders. The draft Chapter recommends that Congress consider amending the legislation pertaining to the section 235 program to require that the loans be financed by borrowings from the Treasury. This conclusion and recommendation are essentially the same as those made in the July 20, 1971 GAO report to the Congress, "Legislation Recommended to Reduce Losses of Two Insured Loan Funds of the Farmers Home Administration -- Department of Agriculture."

With regard to technical aspects, draft Chapter 6 does not contain sufficient data to permit a detailed analysis. We believe that the present value approach which the draft Chapter indicates was used is appropriate for an analysis of this sort. Yet as indicated below we question the appropriateness of the discount rate used in the analysis.

The draft Chapter indicates that the calculations take into consideration "cost recoveries from Federal income taxes," yet there is no indication of how such recoveries were estimated.

[See GAO note,]

In order to provide for coordinated and more efficient financing and thus to reduce the cost of Federal and Federally assisted borrowing activities, the Treasury in December 1971 proposed the "Federal Financing Bank Act of 1971". Secretary Connally stated in his letter transmitting the draft bill to the Congress:

> Interest costs of the various Federal agency financing methods normally exceed Treasury borrowing costs by substantial amounts, despite the fact that these issues are backed by the Federal Government. Borrowing costs are increased because of the sheer proliferation of competing issues crowding each other in the financing calendar, the cumbersome nature of many of the securities, and the limited markets in which they are sold. Underwriting costs are often a significant additional cost factor due to the method of marketing.

Under the proposed legislation these essentially debt management problems could be shifted from the program agencies to the Federal Financing Bank. Many of the obligations which are now placed directly in the private market under numerous Federal programs would instead be financed by the Bank. The Bank in turn would issue its own securities. The Bank would have the necessary expertise, flexibility, volume, and marketing power to minimize financing costs and to assure an effective flow of credit for programs established by the Congress.

The Federal Financing Bank Act (S. 3001), as ordered favorably reported with amendments by the Senate Banking Committee on June 1, 1972, would permit the financing of loan guarantee programs, including the section 235 program, through the Financing Bank. Yet the Senate Banking Committee deleted language in section 7 of the Administration's proposal which would have permitted the Secretary of the Treasury to require guaranteed obligations to be financed through the Bank. We expect that the cost of borrowing by the Financing Bank would differ little from the cost of Treasury borrowing and we believe that enactment of this legislation as proposed by the Treasury would substantially achieve the purpose of your draft recommendations to the Congress.

Sincerely yours,

Jack F. Bennett
Deputy Under Secretary
for Monetary Affairs

Charles P. McAuley
Assistant Director
U.S. General Accounting Office
Treasury Annex Building
Washington, D.C. 20548

GAO note: Material deleted because of changes made in final report.

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

AUG 5 - 1972

Mr. Henry Eschwege
Director, Resources and Economic
Development
General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your request of April 28, 1972, for the views of the Office of Management and Budget regarding Chapter 6 of General Accounting Office draft report on Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance programs.

In Chapter 6, GAO discussed its finding that the program cost (interest subsidies) would be reduced if HUD financed the capital costs of the Section 235 Homeownership Assistance Program with Treasury borrowings rather than by private lenders as is presently required by statute. The Chapter also contains a reference to a similar but earlier GAO proposal for the USDA Rural Housing Program (Section 502) which is presently financed by the sale of borrowers notes.

In a letter to Mr. Samuelson dated February 19, 1971, OMB commented in opposition to the Section 502 proposal. Our views on that proposal remain unchanged at this time.

Regarding the Section 235 proposal, we recognize that, by some measures, Treasury can borrow at lower rates than private investors. However, the GAO projections appear to overstate substantially the potential savings as explained in the comments of the Departments of Housing and Urban Development and Treasury.

As you note in your report other factors must be considered in determining which method of financing is most appropriate for a particular credit program. We believe two factors deserve attention here. The first is the large budget impact of direct Federal financing. HUD estimates that initially an increase of roughly $3.5 billion in annual budget outlays would be required to maintain the Section 235 program level of roughly 200,000 units annually. This of course would be in addition to the continuing budget requirements for long-term interest subsidy payments.

The other factor concerns the desirability of having the Federal Government directly finance a major component of the housing market. The GAO proposal would replace this segment of the private housing market with Federal financing. Fundamentally, we do not believe that it is appropriate for the Federal Government to seek such a major role as a direct lender where the private economy can perform this function effectively. The U.S. economy enjoys a rich variety of private financial institutions, and capital market mechanisms and resources. There are imperfections in this market system, but, in general, the private institutions and mechanisms are remarkably efficient. This being so, the proper role for the Federal Government is to: (a) foster the improvement of institutional and market mechanisms, and (b) limit its credit assistance to providing market incentives for the allocation of financial resources to disadvantaged borrowers. Pursued to its ultimate logical conclusion, the position that the Federal Government should seek a major role as a direct lender could be pressed to justify the Government's taking over all private financial functions.

In our view the uncertain cost savings of a direct loan program do not justify the Federal take-over of this portion of the housing mortgage market, particularly when this part of the market appears to be adequately served by existing institutions and patterns of lending.

In closing, I should note that the Administration has recommended legislation to create a Federal Financing Bank which would have the authority to finance federally insured mortgages and other loans. As discussed in the comments of the Treasury Department, the proposed Bank could substantially achieve the purposes of the GAO recommendation were it determined to be appropriate at the time.

Sincerely,

Caspar W. Weinberger

Casper W. Weinberger
Director

APPENDIX VIII

PRINCIPAL OFFICIALS OF THE

DEPARTMENT OF AGRICULTURE AND THE

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

RESPONSIBLE FOR THE ADMINISTRATION OF ACTIVITIES

DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
SECRETARY OF AGRICULTURE:		
Orville L. Freemen	Jan. 1961	Jan. 1969
Clifford M. Harden	Jan. 1969	Dec. 1971
Earl L. Butz	Dec. 1971	Present
ASSISTANT SECRETARY, RURAL DEVELOPMENT AND CONSERVATION:		
John A. Baker	Mar. 1961	Jan. 1969
Thomas K. Cowden	Apr. 1969	Present
ADMINISTRATOR, FARMERS HOME ADMINISTRATION:		
Howard Bertsch	Apr. 1961	Jan. 1969
James V. Smith	Jan. 1969	Present
SECRETARY OF HOUSING AND URBAN DEVELOPMENT:		
Robert C. Weaver	Feb. 1961	Dec. 1968
Robert C. Wood	Jan. 1969	Jan. 1969
George W. Romney	Jan. 1969	Present
ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT AND FEDERAL HOUSING COMMISSIONER:		
Eugene A. Gulledge	Oct. 1969	Present

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-171630

January 10, 1973

Dear Mr. Chairman:

Enclosed is a copy of our report to the Congress on opportunities to improve effectiveness and reduce costs of the section 236 rental assistance housing program of the Department of Housing and Urban Development.

The report's findings and recommendations, as well as those in our report on the homeownership assistance programs of the Department of Housing and Urban Development and the Department of Agriculture, were included in our statement before the Subcommittee on Priorities and Economy in Government, Joint Economic Committee, on December 4, 1972. We provided a copy of the latter report to the Committee on December 29, 1972.

The report points out that:

--The Department, in allocating program resources, did not insure that all eligible families had the same opportunity to participate in the program regardless of where they lived.

--The Department did not adequately consider purchase price or option price data in its land appraisals. However, revised land appraisal guidelines, issued in April 1972, should help improve the appraisals.

--Incentives, such as low capital investment and income tax shelters, are structured primarily to attract profit-motivated organizations to invest in the construction and initial management of federally subsidized housing and may not be sufficient to insure high-quality management services over the life of the projects.

We are making recommendations to the Secretary of Housing and Urban Development and to the Secretary of the Treasury.

We previously recommended that the Congress consider amending the legislation for the Department of Housing and

B-171630

Urban Development's and the Department of Agriculture's homeownership programs to require direct Federal financing. In this report we are recommending that the Congress consider similar legislation for the section 236 program. Such financing could save about $1.2 billion.

Sincerely yours,

Elmer B. Staats

Comptroller General
of the United States

Enclosure

The Honorable William Proxmire
Chairman, Subcommittee on Priorities
and Economy in Government
Joint Economic Committee
Congress of the United States

REPORT TO THE CONGRESS

Opportunities To Improve Effectiveness And Reduce Costs Of Rental Assistance Housing Program

B-171630

Department of Housing and
Urban Development

*BY THE COMPTROLLER GENERAL
OF THE UNITED STATES*

JAN. 10, 1973

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-171630

To the President of the Senate and the
Speaker of the House of Representatives

This is our report on opportunities to improve effectiveness and reduce costs of the rental assistance housing program of the Department of Housing and Urban Development.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

Copies of this report are being sent to the Director, Office of Management and Budget; the Secretary of Housing and Urban Development; and the Secretary of the Treasury.

Elmer B. Staats

Comptroller General
of the United States

Contents

ABBREVIATIONS

GAO	General Accounting Office
HUD	Department of Housing and Urban Development
OMB	Office of Management and Budget
SMSA	standard metropolitan statistical area

COMPTROLLER GENERAL'S REPORT TO THE CONGRESS

OPPORTUNITIES TO IMPROVE EFFECTIVENESS AND REDUCE COSTS OF RENTAL ASSISTANCE HOUSING PROGRAM
Department of Housing and Urban Development B-171630

D I G E S T

WHY THE REVIEW WAS MADE

Because Federal funds involved could range from $19.6 billion to $49.2 billion and because there were indications of problems in administering the program, the General Accounting Office (GAO) reviewed the Federal program to increase rental housing units for low- and moderate-income families to determine whether the Department of Housing and Urban Development (HUD) could improve its effectiveness and reduce costs.

Background

The need for adequate housing for low- and moderate-income families is one of the major issues facing the Nation. To increase rental housing available to such families, section 236 of the National Housing Act authorized a mortgage insurance program in 1968. The program goal is to provide 1.3 million housing units by 1978.

Under the program HUD pays the mortgage insurance premiums and part of the mortgage loan interest costs. HUD financial assistance, called interest reduction payments, makes lower rents to tenants possible. HUD's section 235 homeownership assistance program was the subject of a previous GAO report to the Congress in December 1972.

FINDINGS AND CONCLUSIONS

Allocation of program resources

In allocating program resources, HUD did not insure that all eligible families had the same opportunity to participate in the rental assistance program regardless of where they lived.

The need for subsidized housing had not been identified adequately and was not used as the primary basis for allocating limited resources. A major factor in allocating resources was an area's capability to produce housing.

HUD headquarters' estimates and the field offices' estimates of the need for subsidized housing differed greatly, and the differences were not reconciled to arrive at reliable data. (See pp. 9 and 10.)

HUD field offices did not receive adequate guidance from headquarters on the allocation of subsidized housing; they approved projects on a first-come, first-served basis. (See pp. 12 to 14.)

Land appraisals

HUD did not adequately consider purchase or option price data in its land appraisals. However, in April 1972, HUD issued revised guidelines

which, if properly followed, should improve the appraisals. (See pp. 17 to 21.)

Method of financing

HUD could save about $1.2 billion in rental assistance program costs if mortgage loans were financed through direct Government borrowings, rather than through private lenders, because of the lower interest rate at which the Government could borrow. (See pp. 22 to 25.)

Incentives to investors

Incentives, such as low capital investment and income tax shelters, are structured primarily to attract profit-motivated organizations to invest in construction and initial management of projects and may not be sufficient to insure high-quality management services over the life of the projects. Tax shelters, in particular, generally expire within the first 10 years of project ownership and are available to project owners regardless of how well or how poorly they manage projects. (See pp. 28 to 34.)

Other program observations

GAO generally found the quality of housing units inspected to be good. (See p. 36.)

HUD did not have adequate data to make a comprehensive analysis of estimated operation and maintenance costs of proposed housing projects. This increased the possibility of its approving projects with rents which were too high for low- and moderate-income families. (See p. 37.)

During the development stage of housing projects, the Dallas field office allowed amounts for legal and organizational fees that were higher than those suggested by HUD guidelines. For 16 projects over $200,000 in mortgage loan proceeds was paid out because of the higher legal and organizational fees allowed. (See p. 37.)

HUD has begun to improve project owners' compliance with its guidelines for establishing and collecting rents and assigning families to housing units. (See pp. 39 and 40.)

The rate of loan defaults is increasing. (See p. 41.)

RECOMMENDATIONS OR SUGGESTIONS

HUD should:

--Insure that rental assistance program resources are allocated primarily in proportion to needs. GAO previously made a similar recommendation on allocating program resources for HUD's homeownership assistance program for low- and moderate-income families. (See p. 15.)

--Monitor field offices' land valuation practices to insure that HUD's revised land appraisal guidelines are being properly followed. (See p. 21.)

HUD and the Department of the Treasury should jointly study the adequacy of the project ownership incentives in promoting good project management and, if necessary, should take appropriate action to restructure the incentives. (See p. 35.)

AGENCY ACTIONS AND UNRESOLVED ISSUES

Allocation of program resources

HUD stated that it does not initiate housing production and does not attempt to force housing in any area but has been informing industry and communities of the benefits of the program and has considered a more intensive effort to stimulate production where most appropriate. If subsidized housing is to be fairly distributed throughout the Nation, HUD must identify the true needs for subsidized housing and must allocate resources primarily according to the needs. (See p. 15.)

Land appraisals

HUD agreed that field office compliance with appraisal guidelines needs to be monitored. (See p. 21.)

Method of financing

HUD, Treasury, and the Office of Management and Budget agreed that the cost of direct Government financing would be lower than financing through private lenders. They said, however, that factors other than cost must be considered, and they made certain observations regarding present and alternative methods of financing. (See pp. 25 and 26.)

Incentives to investors

Treasury questioned whether existing tax shelters encourage investors to sell projects after the shelters expire or to neglect project repair and maintenance. HUD believes new incentives, rather than a change to existing incentives, are needed to encourage project retention and good management and plans to explore this in depth. (See p. 34.)

MATTERS FOR CONSIDERATION BY THE CONGRESS

The Congress should consider legislation which would permit the rental assistance housing program to be financed by the Government, rather than by private lenders, because of the possible savings in interest costs. GAO previously made similar recommendations to the Congress on the financing of HUD's homeownership assistance program and the Department of Agriculture's rural housing program. (See p. 27.)

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CHAPTER 1

INTRODUCTION

The Housing and Urban Development Act of 1968 (42 U.S.C. 1441a) reaffirmed the national goal set forth in the Housing Act of 1949 (42 U.S.C. 1441) of a decent home and a suitable living environment for every American family and established a national goal of constructing or rehabilitating 26 million housing units by 1978--6 million of which are to be provided for low- and moderate-income families with some form of Federal assistance.

Section 236, which was added to the National Housing Act (12 U.S.C. 1715z-1) by section 201 of the Housing and Urban Development Act of 1968, authorized a program under which a portion of the 6 million housing units would be provided to low- and moderate-income families. Under section 236 the Department of Housing and Urban Development (HUD) is authorized to insure privately financed mortgage loans for constructing or rehabilitating multifamily housing projects and to pay, on behalf of the mortgagors, the mortgage insurance premiums and the interest on the mortgage loans in excess of 1 percent. Because HUD makes these payments--called interest reduction payments--a basic monthly rent for each housing unit is established at a rate lower than would apply if the project received no Federal assistance.

Section 236 provides that a tenant pay either the basic rent or 25 percent of his monthly income, whichever is greater, and that a tenant's rent payment not exceed the rent which would apply without Federal assistance. Mortgagors must turn over to HUD rent payments in excess of the basic rent charges to help HUD provide future program assistance.

HOUSING GOALS AND ACCOMPLISHMENTS

The Housing and Urban Development Act of 1968 required the President to set housing unit production goals for each of the major housing programs for the 10-year period June 30, 1968, to June 30, 1978, and to report to the Congress each year on the results achieved. Following are the 10-year

goals and related accomplishments for the section 236 program as report by the President.[1]

Fiscal year	Goals	Accomplishments
	(thousands of units)	
1969	1	1
1970	17	51
1971	77	107
1972	159	147[a]
1973	165	
1974	175	
1975	175	
1976	175	
1977	175	
1978	172	
Total	1,291	

[a]Estimated.

As of June 30, 1972, HUD had insured mortgage loans totaling about $4.5 billion for 2,509 section 236 projects containing 277,502 housing units.

INTEREST REDUCTION PAYMENTS

As of June 30, 1972, the Congress had given HUD authority to make interest reduction payments of $525 million a year. HUD's total payments through June 1972 were about $102.3 million.

HUD estimates that the $525 million annual authority received through June 1972 is sufficient to subsidize 551,500 units and that interest reduction payments might be made on these units for periods ranging from 20 years to

[1]The goals are in the "President's Second Annual Report on National Housing Goals," dated April 1970. The accomplishments are in the "Fourth Annual Report on National Housing Goals," dated June 1972.

40 years--the term of mortgage loans--at a total cost ranging from $8.4 billion to $21 billion. Using HUD's interest reduction payment estimates for the 551,500 units, we estimated that the total interest reduction payments on the 1,291,000 housing units planned to be constructed or rehabilitated under the section 236 program during the 10-year period ending 1978 might range from $19.6 billion to $49.2 billion. In December 1972 HUD advised us that its most recent preliminary evaluation of this cost estimate sets the long-term cost at about $26 billion. However, HUD conceded that the long-term cost might be higher than projected.

ELIGIBLE TENANTS

The authorized financial assistance under section 236 was intended to provide rental housing to families with incomes too high to qualify for public housing but too low to buy standard housing available on the market. To be eligible for admission to a section 236 project, families generally cannot have incomes greater than 135 percent of the limits prescribed for admission to local public housing. If a project cannot be filled by families whose incomes fall within the eligible income limits, families with higher incomes which are able to pay the full market rents may be admitted.

ELIGIBLE MORTGAGORS

To be eligible for HUD mortgage insurance, a project owner may be a nonprofit, cooperative, or profit-motivated corporation or entity. A profit-motivated owner is limited in the distribution of income and may receive an annual return equal to 6 percent of its investment in a project.

PROGRAM ADMINISTRATION

The Assistant Secretary for Housing Production and Mortgage Credit is responsible for developing and promulgating policies, standards, and procedures and for executing them in the field offices with respect to the allocation of contract authorizations for interest reduction payments, approval of projects for mortgage insurance and interest reduction payments, supervision of construction and rehabilitation, and approval of mortgage loans subject to HUD mortgage insurance. The Assistant Secretary for Housing Management is responsible for developing and promulgating policies, standards, and procedures and for executing them in the field offices with respect to the management of housing projects having mortgage loans insured pursuant to section 236 and the management and disposition of projects acquired as a result of loan defaults.

The regional administrators in each of HUD's 10 regions are responsible for the program in their respective regions, and area and insuring offices within the regions carry on the day-to-day administration.

To identify real or potential problems in the administration and operation of the section 236 program, HUD made two major internal program reviews. A central office task force team made the first review between May and July 1971 and issued a report in August 1971. The HUD Office of Audit made the second review between July and December 1971 and issued a report in January 1972. HUD has acted on the findings and recommendations of the two reviews.

Because of the magnitude of Federal funds involved and indications of problems in program administration, we reviewed major aspects of the section 236 program to determine whether opportunities exist for HUD to improve program effectiveness and reduce costs.

HUD's section 235 homeownership program, a sister program of section 236, and the Department of Agriculture's rural housing program were the subjects of a report to the Congress entitled "Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs" (B-171630, Dec. 29, 1972).

CHAPTER 2

NEED TO IMPROVE ALLOCATION OF PROGRAM RESOURCES

HUD did not allocate program resources[1] to reasonably insure that eligible families had an equal opportunity to participate in the section 236 rental assistance program regardless of where they lived. For a fairer distribution of its limited program resources, HUD should better identify the housing needs of low- and moderate-income families and should distribute program resources primarily in proportion to such needs.

HOUSING NEEDS NOT ADEQUATELY IDENTIFIED

HUD headquarters and field offices estimated housing needs for low- and moderate-income families; however, these estimates differed greatly and HUD did not reconcile them to arrive at reasonably reliable data.

Estimates of needs

To estimate the subsidized housing needs for each standard metropolitan statistical area (SMSA)[2] and for each county with an urban center having a population of 8,000 or more, HUD headquarters updated 1960 census data on households and conditions of housing to show intervening construction, demolition, housing deterioration, growth in number of households, aging of population, and changes in family income levels and distributions. HUD annualized the total need estimates to show that portion of an area's needed units which, if provided, could be occupied during a 1-year period.

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[1]HUD program resources are authorizations to the field offices to enter into contracts with lenders for the payments of subsidies.

[2]An SMSA is generally defined as a county or group of contiguous counties which contain at least one city of 50,000 inhabitants or more, or twin cities with a combined population of at least 50,000.

Field office need estimates were to show the maximum number of subsidized housing units which could be sold in an area during a 1-year period. Field office personnel were allowed little time to prepare the estimates, and they told us that their estimates were nothing more than educated guesses.

Rather than reconcile the differences between HUD headquarters' estimates and the field offices' estimates, HUD used an average of both estimates in its allocation formula. For example, headquarters estimated that one field office needed about 6,600 units, whereas that field office estimated only about 2,000 units. Although the headquarters' estimate was over three times that of the field office, HUD used an average of 4,300 to determine how program resources would be allocated in fiscal year 1971.

NATIONAL ALLOCATION OF PROGRAM RESOURCES

A major factor in determining where HUD resources were to be allocated was an area's capability to produce housing. As a result, not all areas of the Nation participated in the program in proportion to their indicated needs.

Because HUD's homeownership program, authorized by section 235 of the National Housing Act, serves the same income group as the section 236 program, HUD developed one combined estimate of housing needs to be met by both programs. In our report on the homeownership programs administered by the Department of Agriculture and HUD, we compared the actual distribution of sections 235 and 236 housing units to individual States from program inception (August 1968) to December 1971 with HUD headquarters' estimates of housing needs which HUD officials advised us were the best approximation of nationwide needs.

Our comparison showed that several States had received far fewer housing units than their share as indicated by estimated housing needs. This was especially true for the Northeastern States. About 11 percent of the housing units provided through December 1971 were in the Northeastern States, which would have received about 32 percent of the housing units had they been allocated on the basis of HUD need estimates.

HUD allocated section 236 program resources to its 77 field offices primarily on the basis of a formula which considered production capacities and estimated needs for subsidized housing in the area served by the field office. The allocation formula used prior to March 1971 emphasized production capacities rather than estimated needs; therefore, areas most active in producing subsidized housing received a greater proportion of the available program resources.

HUD recognizes that need is an important factor in allocating limited program resources and has increased its emphasis on this factor in allocating section 236 program resources. In the March 1971 allocation, HUD gave equal weight to the factors of subsidized housing needs and production capacities. In the fiscal year 1972 allocation, HUD changed the relative weights assigned to these two factors to 60 percent and 40 percent, respectively.

LOCAL ALLOCATION OF PROGRAM RESOURCES

A basic problem encountered by HUD field offices was inadequate guidance by headquarters on the procedures and policies for allocating program resources. The field offices included in our review authorized the construction or rehabilitation of subsidized housing primarily on a first-come, first-served basis and did not attempt to insure that each housing market area received a reasonably fair share of the section 236 housing.

From program inception, authority to approve section 236 housing projects was delegated to the HUD field offices. HUD instructions provided that some of the factors to be evaluated in deciding whether to approve specific projects were locations, time required for completion, estimated costs, and various social factors. The evaluation factors were modified somewhat in 1969 and again in 1971 to emphasize the geographic dispersion of subsidized projects and to implement the President's policy for equal opportunities in housing.

Following is our comparison of the sections 235 and 236 housing provided with the estimates of needs for housing market areas under the jurisdiction of HUD's Atlanta, Dallas, and Los Angeles area offices.

HUD field office and housing market area	Housing units produced August 1968 through December 1971 Section 235	Section 236	Total	Percent	Estimate of needs (note a) Units	Percent
Atlanta:						
SMSAs:						
Atlanta	1,877	2,562	4,439	24.7	5,953	44.6
Albany	717	42	759	4.2	278	2.1
Augusta	1,441	200	1,641	9.1	801	6.0
Columbus	1,781	104	1,885	10.5	300	2.2
Macon	1,669	528	2,197	12.2	803	6.0
Savannah	528	-	528	2.9	969	7.3
Counties:						
Baldwin	41	-	41	.2	180	1.3
Clarke	265	-	265	1.5	303	2.3
Floyd	22	120	142	.8	250	1.9
Hall	27	-	27	.2	232	1.7
Lowndes	522	104	626	3.5	234	1.8
Thomas	103	-	103	.6	201	1.5
126 other counties	4,408	906	5,314	29.6	2,847	21.3
Total	13,401	4,566	17,967	100.0	13,351	100.0
Dallas:						
SMSAs:						
Dallas	7,731	6,606	14,337	85.5	5,573	61.5
Sherman-Denison	262	248	510	3.0	387	4.2
Tyler	183	372	555	3.3	313	3.4
Waco	39	-	39	.2	748	8.3
Counties:						
Bell	9	360	369	2.2	587	6.5
Gregg	166	100	266	1.6	273	3.0
Lamar	100	-	100	.6	180	2.0
Navarro	7	-	7	-	159	1.8
14 other counties	406	200	606	3.6	838	9.3
Total	8,903	7,886	16,789	100.0	9,058	100.0
Los Angeles:						
SMSAs:						
Anaheim-Santa Ana-Garden Grove	493	593	1,086	7.9	2,917	8.0
Bakersfield	627	294	921	6.7	1,356	3.7
Los Angeles-Long Beach	1,282	6,040	7,322	53.0	26,082	71.5
Oxnard-Ventura	281	540	821	6.0	839	2.3
San Bernardino-Riverside	2,356	1,047	3,403	24.7	3,558	9.8
Santa Barbara	40	75	115	.8	1,104	3.0
County:						
San Luis Obispo	-	120	120	.9	609	1.7
Total	5,079	8,709	13,788	100.0	36,465	100.0

[a]Represents the needs for sections 235 and 236 units through December 1971. HUD headquarters prepared the estimates.

As shown above, the field offices' distribution of sections 235 and 236 housing to individual housing market areas in many instances did not approximate the ratios which the housing needs of the individual market areas bore to the housing needs of the entire areas served by the field offices. HUD officials of the three offices informed us that they generally considered applications for housing projects on a first-come, first-served basis and that they often approved a project on the basis of the project owner's ability to quickly get the project operational.

We noted that HUD field offices did not attempt to stimulate the construction or rehabilitation of housing in market areas where builders were not active, even though the need for subsidized housing in those areas might have been acute. Also, HUD did not develop and maintain adequate statistical data on the number of subsidized housing units being processed and approved in each market area. This lack of information may have contributed to the approval of more housing in certain areas than was indicated as needed.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our draft report, HUD stated (see app. II) that the allocation system provides maximum fairness among the 77 HUD field offices. HUD stated also that it does not initiate housing production, nor does it believe that housing development should be forced in any area. HUD pointed out that such factors as the availability of builders, willingness of financial institutions to participate in the program, and resistance of local communities to housing for lower income families influence housing production in a given area. HUD pointed out that the ratio of housing provided to housing needs in the central city was higher than the ratio for the suburbs partly because the housing needs of the central cities, at the outset of the program, seemed more urgent than the needs of the suburbs. Also, HUD field offices were located in the central cities and housing developers and others interested in subsidized housing were more active in the central cities. We were told that HUD had been informing industry and communities of the benefits of the section 236 program and was considering a more intensive effort to stimulate production where it is most needed. Efforts to spur production in certain areas is necessary if subsidized housing is to be fairly distributed throughout the Nation. However, to make a fair distribution, HUD must first identify the true needs for subsidized housing and must make every effort to allocate program resources according to the needs.

HUD was of the opinion that its Project Section Criteria System, put into effect in February 1972, would significantly affect locational decisions of the field offices and would help meet the allocation problems we identified. Although the system can be helpful in evaluating such factors as management plans and the environmental impact of proposed individual projects, it is not directed, in our opinion, to the problems of identifying needs and allocating resources.

RECOMMENDATION

We recommend that the Secretary of HUD insure that resources under the section 236 program are allocated primarily in proportion to needs.

In our report on HUD's section 235 program, we made a similar recommendation on the allocation of section 235 program resources.

CHAPTER 3

ACTION TAKEN TO STRENGTHEN LAND APPRAISAL PROCEDURES

Because HUD gave little or no consideration to property owners' purchase or option price data in its land appraisals to establish section 236 mortgage amounts, the mortgage loans might have been larger than they would have been if HUD had adequately considered purchase or option price data. Higher mortgage loans result in higher interest reduction payments by the Government and probably higher rents to project tenants. In April 1972 HUD issued revised guidelines which, if properly implemented, should improve its land appraisals.

HUD LAND APPRAISAL PROCEDURES

In determining the amount of an insured mortgage loan for multifamily housing, such as a section 236 project, HUD estimates the replacement cost of the project, including the fair market value of the improved land. For a profit-motivated project owner, the insured mortgage loan amount generally is limited to 90 percent of a project's estimated replacement cost; for nonprofit owners, the insured mortgage loan amount may equal 100 percent of replacement cost.

At the time of our review, HUD determined the value of a proposed project site by measuring it against comparable sites (usually five) which had been recently sold or offered for sale and which had elements of utility and desirability similar to those of the proposed site. To bring the other sites and their prices into proper perspective with the site being appraised, HUD adjusted the prices of the comparable sites to compensate for differences in locations, recency of sales, zoning classifications, sizes, and off-site improvements.

HUD LAND APPRAISALS

We examined the land valuation assigned to 68 recently completed section 236 projects administered by HUD field offices in Atlanta, Dallas, and Los Angeles. Each of the field offices used the HUD land appraisal procedures and gave little or no consideration to the owners' costs. HUD valued project land above its cost to the owner for 47 of the 68 projects. For 12 of the 47 projects, the HUD valuations ranged from 126 to 333 percent of the owners' costs; HUD had made the valuations within 17 months of the owners' acquisitions of land, as shown below.

	Project land			Months between purchase or option agreement and HUD valuation
		HUD valuation		
HUD field office	Cost (note a)	Amount	Percent of cost	
Atlanta	$ 61,400	$157,000	256	3
	22,503	75,000	333	17
	72,502	96,000	132	2
Dallas	149,750[b]	311,500	208	7
	116,320[b]	250,000	215	6
	125,886[b]	235,200	187	4
	116,520[b]	223,700	192	8
	260,020[b]	356,000	137	1
Los Angeles	317,400	415,800	131	17
	158,000	228,600	145	7
	271,407	341,000	126	17
	198,800	251,500	127	11

[a]Includes estimated costs of offsite improvements, demolition, and other related land improvements.

[b]The sponsors of these projects held purchase options at the time of the HUD appraisals.

At the Dallas project, where HUD valued the land at $311,500, an individual had obtained a purchase option in March 1969 to buy it for $143,000 (not including estimated offsite and other costs totaling $6,750). On the same day he offered the land to his father-in-law for $311,500. The

father-in-law submitted an application to HUD for a section 236 project, claiming $311,500 as his purchase price. In June 1969 a HUD appraiser assigned a value of $311,500 to the land (50 cents a square foot) as determined by his analysis of five other land sales. The HUD appraiser did not include in the five land sales an adjacent parcel of land on which another section 236 project was being constructed. About 3 months earlier HUD had valued the adjacent parcel at about 41 cents a square foot (about 20 percent less).

In September 1969 the HUD regional office reviewed the project application and requested the Dallas field office to reanalyze the value of the land because of the substantial difference between the amount allowed in the June 1969 appraisal and the March 1969 option price and because four of the five land sales used in the appraisal were not sufficiently comparable to make a valid comparison. In October 1969 the HUD appraiser reappraised the project land and, using five different land sales, again valued the land at $311,500. The appraiser was of the opinion that the son's offer to sell the land to the father-in-law for $311,500 was representative of the land's fair market value.

In an Atlanta project an individual had an option to buy the land for $72,502, subject to the condition that the seller obtain a zoning reclassification for multifamily use. The rezoning was obtained, and 2 months after the sale, HUD valued the land at $96,000, or 32 percent higher than the buyer's cost.

Because the value HUD places on the land is included in the amount of the mortgage loan, the higher the valuation, the greater are the interest reduction payments and, probably, the rents. For example, we estimated that the difference between HUD's valuation of, and the cost of, land for the 12 projects would result in about $2 million more interest reduction payments over the life of the mortgage loans.

We discussed land appraisal procedures with two realtors in Dallas and with members of the American Institute of Real Estate Appraisers in Los Angeles, who told us that the use of cost data was generally an excellent measure of fair value. Information provided by the institute indicated

that there are three approaches to determining value--cost, discounted value of future income, and comparison with recent sales of comparable properties. The institute advised us that most appraisers use all three approaches as checks against each other and as tests of their own judgments.

In a report issued in January 1972, the HUD Office of Audit stated that HUD estimates of land values made shortly after the project owners had acquired the land generally exceeded the owners' actual costs. The report cited eight examples in which, within 1 year of the owner's purchase, HUD had valued the land from 65 to 195 percent higher than its cost to the owner.

The Office of Audit interviewed officials of four mortgage companies in San Antonio and Oklahoma City regarding conventional practices in valuing land for mortgage loans. The officials said that, if a project owner had acquired land in the past year, the loan value of land generally should be about the same as the purchase price.

REVISED HUD GUIDELINES

On April 12, 1972, HUD headquarters issued revised guidelines to the field offices, which, in part, prescribed new land appraisal procedures. The guidelines pointed out that many land appraisals had been poorly prepared and documented. HUD directed that

--accurate and timely land sales data be accumulated and maintained;

--land sales prices, offsite improvement costs, demolition costs, and any costs to make the sites usable be noted;

--data on three or more comparable sales be obtained and included as part of each appraisal file;

--comparable sales not be used as the sole basis for determining land values; and

--HUD appraisals which exceed the sponsors' costs be fully justified in the appraisal files.

We believe that the new guidelines, if properly implemented, should improve HUD's land appraisals and should help insure that reasonable values are given to project land.

RECOMMENDATION

We recommend that the Secretary of HUD monitor the field offices' land valuation practices to insure that HUD's revised land appraisal guidelines are being properly followed.

AGENCY COMMENTS

HUD agreed that field office appraisals needed to be monitored but stated that the appraisals must consider market values or else prudent landowners might use the land for other purposes which recognize its market value. HUD stated also that its appraisal guidelines are based on sound appraisal principles and practices and that, if the guidelines are followed, there should be little possibility of windfall profits on land.

CHAPTER 4

METHOD OF FINANCING

The Government could achieve substantial savings in section 236 program costs if mortgage loans were financed directly by the Government rather than by private lenders. These savings are possible because of the lower annual interest rate at which the Government could borrow, compared with the interest rates available in the private mortgage money market.

We estimated that savings on the section 236 program could amount to about $1.2 billion. The savings possible on the section 235 program and on the section 502 rural housing and certain other loan programs administered by the Farmers Home Administration, Department of Agriculture, were discussed in previous GAO reports.[1] In those reports, we stated that the Congress might wish to amend the legislation governing the programs to enable the section 235 program to be financed by Treasury borrowings rather than by private lenders and to enable the Farmers Home Administration's loan programs to be financed by Treasury borrowings rather than by sales of borrowers' loan notes.

OPPORTUNITY TO REDUCE PROGRAM COSTS

Under the present method of financing the section 236 program, project owners obtain loans for constructing or rehabilitating housing from HUD-approved lending institutions at interest rates established by HUD (7 percent at Dec. 31, 1972). HUD insures the loans and pays, on behalf of project owners, all interest in excess of 1 percent on the loans and the loan insurance premiums.

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[1] Reports to the Congress, entitled "Opportunities to Improve Effectiveness and Reduce Costs of Homeownership Assistance Programs" (B-171630, Dec. 29, 1972) and "Legislation Recommended to Reduce Losses of Two Insured Loan Funds of the Farmers Home Administration" (B-114873, July 20, 1971).

If the subsidized loans made under the section 236 program were financed by Treasury borrowings rather than by private lenders, the Government could take advantage of its ability to borrow funds at lower interest rates than those charged by private lenders. Data compiled by the Federal National Mortgage Association shows that the interest yield on multifamily mortgage loans insured by HUD was 7.62 percent in August 1972. The interest yield on a recent issuance of long-term Treasury bonds ($2.3 billion on Aug. 15, 1972) was 6.5 percent.

On the basis of information in the "President's Second Annual Report on National Housing Goals," dated April 1970, we calculated that loans for new and rehabilitated units to be provided under the section 236 program during fiscal years 1973 through 1978 would amount to about $20.1 billion. We estimated that, if these loans were made with Treasury borrowings and if the project owners received assistance payments for an average of 20 years, the present value of savings to the Government would amount to approximately $1.2 billion.[1]

We used the present-value method to estimate savings because we believe this is the most appropriate method of estimating long-range costs. Under the present-value method, the current values of fund flows over a specific period are calculated by using a discount rate. Discounting future costs makes them comparable to present costs; i.e., to the present value of costs. We used the 6.5-percent yield on long-term Government bonds sold in August 1972 as the discount rate.

Our estimate considered (1) Federal tax revenues on income to private lenders and to investors in Government securities, (2) costs incurred by the Government under the "tandem plan"--a plan under which the Government National Mortgage Association and the Federal National Mortgage Association provide joint financial assistance in financing

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[1] This estimate was based on the 1.04 million new and rehabilitated units planned to be provided under the section 236 program during fiscal years 1973 through 1978.

section 236 mortgages, and (3) costs of servicing mortgage loans under a Government direct loan program.

We believe that the loan servicers who process and service privately financed section 236 loans could also process and service Government-financed loans and that their fees would be the same for both kinds of loans.

CONCLUSIONS

Section 236 program costs could be substantially reduced if HUD were authorized to make loans to project owners with Treasury borrowings. The savings could be realized without significantly disrupting the relationship between HUD and the lending institutions that currently service section 236 loans.

We recognize that cost is not the only factor to be considered in determining which method of financing is most appropriate for a particular program. However, we believe that the Congress should be made aware of the cost savings that could be realized by an alternative method of financing the program.

AGENCY COMMENTS AND OUR EVALUATION

HUD, Treasury, and the Office of Management and Budget (OMB), although recognizing that Treasury could borrow funds at lower interest rates than available in the private mortgage money market, made certain observations on behalf of the present method of financing. These comments are presented in appendixes II, III, and IV and are summarized below.

HUD

HUD referred to its comments on our recommendation that section 235 mortgage loans be financed by the Government. In those comments HUD suggested that direct Federal financing might cause the interest rate of Treasury borrowings to increase. However, a Treasury official advised us that the increase in Treasury borrowings would not cause any appreciable increase in the interest rate.

HUD stated that the cost of direct Federal financing might equal or exceed the cost incurred under the present method because of the need for refinancing the public debt. Our estimate of savings is based on the assumption that funds would be obtained through long-term Treasury borrowings; therefore, refinancing should not be necessary.

HUD stated that substantial staff increases would be required to process loan applications and to establish and maintain accounting records and reports. Our review indicated that most mortgagees involved in the program would be willing to perform these services for HUD at no increase in cost over that under the present method of financing. In these circumstances, substantial staff increases would not be needed.

HUD commented that direct Federal financing of the program would result in a larger Federal budget and increased cash flows from Treasury. We agree, but this would be true only during the early years because loans, together with interest, would be repaid later. Because of the more favorable interest rates for Treasury borrowings, the direct loan method of financing the section 236 program could reduce the net costs to the Government without increasing rents to lower income families.

Treasury

Treasury stated that its views on Government financing of the section 236 mortgage loans were the same as those expressed in its comments on our recommendation for the section 235 program. In those comments Treasury agreed that the present-value method of calculating potential savings was appropriate. Treasury stated also that enactment of legislation which it proposed in December 1971 and which would create a Federal bank to finance Government loan guarantee programs would substantially achieve the objective of our recommendation. The 92d Congress did not enact this legislation.

OMB

OMB stated that its views were the same as those expressed in its comments on our recommendation for the section 235 program. In those comments OMB, like HUD, commented that direct Federal financing of the section 235 program would require a larger Federal budget. In addition, OMB expressed the view that the Government should not seek a major role as a direct lender when the private economy can perform this function effectively. We believe that this is a policy question to be considered by the Congress.

MATTERS FOR CONSIDERATION BY THE CONGRESS

Because of the potential interest savings, we recommend that the Congress consider legislation which would permit section 236 loans to be financed by the Government rather than by private lenders. We have previously recommended that the Congress consider amending the legislation to require direct Federal financing of the section 235 homeownership program and the section 502 rural housing program.

CHAPTER 5

INCENTIVES TO INVESTORS

HUD's eligibility requirements for ownership of section 236 projects provide that a mortgagor may be a profit-motivated, nonprofit, or cooperative corporation or entity. (See p. 7 .) Profit-motivated organizations own about 60 percent of all section 236 projects.

In addition to the return on equity investment, incentives to profit-motivated organizations to invest in the development and management of section 236 projects include low capital investment, income tax shelters, and opportunities to profit by participating in more than one phase of project development and operation.

The existing incentives are structured primarily to attract profit-motivated organizations to invest in the construction and initial management of projects and may not be sufficient to insure that high-quality management services, which are essential to the success of the program, are provided over the life of the projects. Income tax shelters, in particular, generally expire within the first 10 years of project ownership and are available regardless of how well or how poorly the owners manage the projects.

Most projects have been in operation less than 3 years; therefore, it is too early to assess the long-term impact of the incentives now available to investors. However, because of the importance of good management, we believe HUD and Treasury should make a joint study to determine whether the incentives need to be restructured to give more emphasis to this aspect of the program.

Each incentive is discussed in further detail below, and examples of the tax shelters are included as appendix I.

LOW CAPITAL INVESTMENT

To obtain a HUD-insured section 236 mortgage loan, a profit-motivated owner is required by law to have at least a 10-percent investment in the project. This investment is based on the project's estimated replacement cost.

An owner's cash investment in a project, however, may be substantially less than 10 percent of the project's replacement cost because HUD permits the owner to use the difference between HUD's appraised value and the owner's cost for the land (see ch. 3) and to use certain allowances to meet the investment requirement. For example, if the owner is also the general contractor, HUD permits the owner to use the builder-sponsor profit and risk allowance--an amount equal to 10 percent of the estimated construction cost which is included in the project's replacement cost--to help meet the investment requirement.

INCOME TAX SHELTERS

Incentives to invest in federally subsidized multifamily housing have been provided in the form of tax shelters that may be used to reduce Federal income tax liabilities. Some of the tax shelters include accelerated depreciation, recapture of accelerated depreciation in event of sale, 5-year writeoffs of rehabilitation costs, deferments of taxable gains when they are reinvested in other subsidized housing, and allowance of fair market values rather than depreciated costs as deductible items when housing is donated to qualified charitable organizations.

Accelerated depreciation

The owner of a newly constructed section 236 project is permitted to depreciate the construction cost at an accelerated rate, using either the double-declining balance or the sum-of-the-years-digits method of depreciation. This depreciation expense, combined with other operating costs of the facility, often results in a loss from operations which can be offset against income from other sources and which thereby can reduce tax liabilities. The advantage of accelerated depreciation diminishes rapidly after about the 10th year of project operation. (See app. I.)

Multifamily rental housing is the only type of real estate investment which can use the maximum rate of accelerated depreciation (200 percent of the straight-line rate applied to a declining balance) permitted by the 1969 revisions to the Internal Revenue Code. Commercial and industrial facilities can claim accelerated depreciation at a rate of 150 percent of the straight-line rate applied to a declining balance.

Recapture of excess depreciation in event of sale

Federally subsidized rental housing, such as section 236 housing, receives preferential tax treatment over nonsubsidized rental housing with respect to the recapture of excess depreciation in the event of sale of the property. As a result of the 1969 revisions to the Internal Revenue Code, any excess depreciation which is claimed on new,

unsubsidized rental housing projects is treated as ordinary income (recaptured) instead of capital gains, if the property is sold within 100 months and a gain is realized. If the property is sold after 100 months, the amount of excess depreciation treated as ordinary income is reduced by 1 percent a month, so that property must be held for 16 years and 8 months (200 months) for all of the gain to be treated under the more favorable capital gains tax rates.[1]

All excess depreciation for subsidized rental housing is treated as ordinary income during the first 20 months of project operation, and any residual gain is taxed at capital gains rates. Thereafter, the amount of excess depreciation recaptured as ordinary income is reduced by 1 percent per month, so that all the gain on a sale of property held 10-years is given the more liberal capital gains treatment. This preferred treatment applies only to property built or acquired before 1975.

The tax recapture provisions appear to induce owners to sell after 10 years of project ownership rather than maintain long-term ownership. (See app. I.)

Rehabilitation costs

The 1969 revisions to the Internal Revenue Code provide that rehabilitated housing be given special tax consideration so that the owners of such housing may write off the rehabilitation expense over a 5-year period rather than over the remaining useful life of the project. This special writeoff is available only for rehabilitation expenses incurred before 1975. (See app. I.)

Deferment of taxable gain through reinvestment

The 1969 revisions to the Internal Revenue Code permit an investor in a subsidized housing project to defer the gain on the sale of the project if he reinvests the proceeds in another subsidized housing project.

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[1] In the event of sale of the property during the first 12 months of operations, all depreciation claimed is subject to recapture as ordinary income.

To qualify for the tax deferment, the investor must reinvest within 1 year from the date of sale of the first project (unless the Internal Revenue Service approves a longer period) and must sell to the tenants of the project, a cooperative, or a qualified nonprofit organization.

Upon sale of the second property, any excess depreciation claimed on both properties can be recaptured as ordinary income (see p. 30); the holding period is based on the combined length of ownership of both properties. For example, if the first project was held 5 years before sale and the second property was also held 5 years, the combined holding period would be 10 years. After 10 years, any gain realized on the sale of subsidized rental housing is subject to the more liberal capital gains tax treatment.

Donation of property to a charitable institution

The owner of a section 236 project can realize a substantial tax benefit by donating the project to a qualified charitable organization. When a project is donated, a deduction equal to the fair market value is allowed. Since real estate often appreciates in value, the deduction may be substantially more than the project's depreciated cost.

The Internal Revenue Code provides that the full fair market value of an appreciated asset may be claimed as a contribution, if the asset would not have been subject to recapture of depreciation had it been sold. Therefore, when an owner holds a section 236 project for at least 120 months, he can donate it to a qualified charitable institution and use its fair market value as a tax deduction. The amount of the deduction must be reduced by any portion of the appreciation which would have been treated as ordinary income if the project had been sold before 120 months.

This and the other tax incentives discussed above can provide substantial tax shelters for investors with large incomes from other sources.

Interest subsidy payments

As noted earlier, the Government pays to mortgagees, on behalf of project owners, interest subsidies to reduce

the projects' operating costs which, in turn, permit lower rent charges for housing units. The subsidy payments are equal to the difference between the monthly payment on the privately financed loan (currently the maximum interest rate is 7 percent and the loan term is 40 years) and a monthly payment on a loan in the same amount and for the same term with interest at a rate of 1 percent.

The interest subsidy is a fixed amount, and the interest portion of the monthly payment on the privately financed loan ranges from about 94 percent of the monthly payments in the first year to less than 4 percent in the 40th year of the loan. Therefore, the interest subsidy payments in the later years of the loan are larger than the actual interest on the subsidized loan, as illustrated below for a loan of $720,800.

	Loan payments		Interest subsidy
	Total	Interest	payments
1st year	$53,751	$50,348	$31,880
10th year	53,751	47,873	31,880
20th year	53,751	40,933	31,880
30th year	53,751	27,992	31,880
40th year	53,751	1,983	31,880

The Internal Revenue Service told us that project owners, in computing their Federal tax liabilities, must include as gross income the full amount of the interest subsidy payments each year and may deduct as expenses the total interest included in the loan payments. Such treatment for tax purposes does not disturb the tax shelters that accrue to owners in early years of projects but does induce project owners to sell the projects when the subsidy payments equal or exceed the interest payments on the loans.

PARTICIPATION IN MORE THAN ONE PHASE OF PROJECT DEVELOPMENT AND OPERATION

The owner of a section 236 project may also profit from participating in the construction and management of a project. In many instances the owner also is the general construction contractor. The owner can have interest in the architecture firm which designs the project and in the firms which subcontract for the general contractor.

Many project owners also own real estate management firms which provide the project with management, custodial, and bookkeeping services.

AGENCY COMMENTS AND OUR EVALUATION

Treasury questioned whether tax shelters encourage investors to sell projects after the shelters expire or to neglect project repair and maintenance. Treasury pointed out that a decision based on minimizing taxes may not maximize after-tax returns and that the sales price of a project depends partly on past repair and maintenance.

HUD stated that the tax incentives, in particular, had greatly influenced the motivation of investors in the program and that some imbalance might exist between the production incentives and long-term retention or management incentives due to the special tax provisions. HUD said that the crucial point is not whether a well-managed project changes ownership but whether sound management continues. However, it stated that the concern with ownership has some validity because owners of projects often manage them. HUD was of the view that developing new incentives which encourage project retention or good management should be stressed, rather than reducing or shifting incentives, such as using the builder-sponsor profit and risk allowance to meet project investment requirements and special tax provisions. HUD stated that it plans to study this in depth.

Although HUD's views merit consideration, we believe Treasury, as well as HUD, should make the study because it would include an evaluation of tax incentives.

RECOMMENDATION

We recommend that the Secretaries of HUD and Treasury jointly study the adequacy of the section 236 project ownership incentives in promoting good management and, if necessary, take action to restructure the incentives to help achieve this goal.

CHAPTER 6

OTHER PROGRAM OBSERVATIONS

QUALITY OF HOUSING

In the four field offices included in our review, we inspected 518 rental units in 40 projects to evaluate the quality of the housing. We also discussed the quality of housing with tenants, owners, and managers. During each inspection a HUD construction engineer or building inspector assisted us.

Generally, the quality of housing was good and most housing defects were minor, such as loose bathroom fixtures, small roof leaks, and loose floor tiles. Only one project, in the New York area, had a defect which the HUD inspector considered more than minor. In that project, the air-conditioning ducts were improperly installed and serious water leakage and drafts in apartments were possible.

Generally the project managers were already aware of the defects noted and, in most cases, were taking or planning corrective actions.

OPERATION AND MAINTENANCE COSTS

The cost to operate and maintain section 236 projects is a major factor in establishing the rental rates. Since the program was designed to serve the needs of a limited-income group, it is essential that operation and maintenance costs be at a level that permits rent charges to be set within the means of that target group. (It has generally been established that low- and moderate-income persons cannot afford to pay more than 25 percent of their incomes for rent.)

Before approving construction of a project, HUD evaluates the estimated costs of operation and maintenance, to determine whether the project can be satisfactorily operated at costs which will permit rents within the means of the proposed tenants. HUD field offices, in making these evaluations, have been instructed to use operation and maintenance costs experienced by other subsidized housing projects.

The HUD field offices generally did not have adequate data available against which to measure proposed costs of a project. Our review of 31 projects in four field offices showed that about 39 percent of these projects had experienced operating costs which exceeded the HUD estimates. Some project owners had requested increases in rents because operation and maintenance costs were higher than expected. In our opinion, the lack of sound data for use in estimating project operating costs increases the possibility of approving projects with rents which are too high for low- and moderate-income families.

The HUD Office of Audit and the HUD central office task force team made the same observations. The Office of Audit found a consistent pattern of underestimation of project operating expenses in 17 of 21 HUD field offices and related the underestimates to outdated and incomplete cost data. The HUD task force noted that unrealistic operating expense estimates had caused several owners to request rent increases soon after the projects became operational.

In April 1972 HUD revised its guidelines for estimating project operating expenses to require that the estimates be documented by including actual costs from at least three similar projects and that significant variances between the estimates for a project and costs experienced on similar projects be explained.

VARIANCES IN FEES ALLOWED FOR LEGAL AND ORGANIZATIONAL EXPENSES

Legal and organizational fees claimed by project owners for attorneys' fees and expenses incurred in planning, financing, and constructing projects and allowed by the HUD Dallas field office for inclusion in project costs were higher than suggested by HUD guidelines.

For 16 profit-motivated projects completed in the Dallas area through September 30, 1971, the total legal and organizational expenses allowed by HUD amounted to $450,800, whereas the fees indicated for these projects by HUD guidelines would have been $247,900, a difference of $202,900. The expenses allowed on the projects ranged from $17,927 to $42,175 and, except when total expenses were limited to a

locally imposed maximum of $27,500, generally amounted to about 1 percent of the mortgage loans.

HUD guidelines state that legal and organizational expenses included as a cost of a project should be typical and necessary costs incurred for projects of the size and kind proposed in the locality in which the project will be built. To help estimate these expenses, the guidelines provide a schedule in which fees are set on a sliding scale ranging from three-fourths of 1 percent for the first $1 million mortgage loan to three-twentieths of 1 percent of the loan in excess of $10 million. The guidelines state that the amounts determined, if substantiated, may be more than those that would be found through a strict application of the schedule. The project files contained no evidence that the expenses allowed were typical of costs incurred in similar projects in the area.

HUD's attorney in Dallas analyzed the legal and organizational expense allowances in the latter part of 1970. The analysis identified the typical tasks involved in providing legal and organizational services for a multifamily project and estimated the amount of time required to perform each task--an average of 16.5 days, with a maximum of 32 days. Using a $250-a-day legal services rate which was derived from HUD's minimum schedule, HUD's attorney estimated that the legal and organizational fees under these circumstances would range from $4,125 to $8,000 a project. HUD's attorney pointed out, however, that lawyers with the expertise to command a higher fee should benefit HUD. For example, he stated that a lawyer with the ability to work closely with mortgagees might be able to obtain lower mortgage discounts for the project owner and that a discount lowered only a fraction of a percent would justify an attorney's higher fee.

The difference between the legal and organizational fees allowed by the Dallas field office and those suggested by HUD guidelines indicates a need for the HUD central office to periodically monitor the field office operations.

HUD stated that the Dallas field office is unusual in the degree to which it departs from the guidelines and that it plans to follow up on this matter.

OWNERS' COMPLIANCE WITH HUD GUIDELINES FOR RENTS, ASSIGNMENT OF FAMILIES TO HOUSING UNITS, AND RENT COLLECTIONS

At selected projects we reviewed project owners' compliance with HUD guidelines for establishing rents, remitting to HUD the rents collected in excess of basic rents, and placing families in housing units according to the family sizes and makeups.

In the Dallas area we examined the tenant records for 175 housing units at 10 projects. Tenants of about 5 percent of the units were being charged about $1,200 less rent per year than they should have been charged on the basis of their reported incomes.

In the Los Angeles area we examined the tenant records for 728 housing units at 10 projects. Tenants of 4 percent of the units were being charged about $4,000 less rent per year than they should have been charged on the basis of their reported incomes. About 5 percent of the 728 units were occupied by smaller sized families than suggested by HUD guidelines.

In the New York area we examined the tenant records for 118 housing units at 10 projects. We found instances of undercharging rents, charging rents in excess of basic rents that were not turned over to HUD, and allowing tenants to occupy units of incorrect size. In addition, the files had no income verifications for 19 tenants and 13 tenants had submitted income data after occupancy. The income verifications for 27 tenants, contrary to instructions, were over 60 days old when the tenants took possession of the housing units. In September 1971 three project owners understated their collection of rents exceeding basic rents by about $726, and one did not report $3,230 in excess rents.

HUD's Office of Audit, in its review at 62 projects, found similar deficiencies.

In commenting on our findings, HUD cited several actions that it had taken since our review to improve project owners' compliance with HUD guidelines. These actions

included (1) initiating preoccupancy conferences with owners to teach them about the tenant eligibility requirements, (2) increasing the monitoring of certification and verification of tenant incomes, (3) increasing staffs of field offices to administer the program, and (4) initiating workshops to familiarize field office personnel with the subsidized housing programs and the need to review and supervise the management of section 236 projects.

We believe that these actions, if properly implemented, should help to improve project owners' compliance with HUD's project management guidelines.

LOAN DEFAULTS

Of the 2,509 section 236 mortgage loans insured by HUD as of June 30, 1972, five had been foreclosed and the mortgaged property conveyed to HUD and 29 had been assigned to HUD because of payment defaults. In addition, 97 insured loans were in default because of delinquent payments. In total, these 131 loans represented about 5.2 percent of the loans.

The following schedule shows the number of insured loans and the number and percentage of loan defaults at the end of each month during fiscal year 1972.

Month	Insured loans	Loan defaults	Percent
July 1971	1,537	44	2.9
August 1971	1,590	49	3.1
September 1971	1,682	44	2.6
October 1971	1,733	47	2.7
November 1971	1,814	56	3.3
December 1971	1,910	60	3.0
January 1972	2,052	76	3.7
February 1972	2,147	86	4.0
March 1972	2,231	96	4.3
April 1972	2,333	108	4.6
May 1972	2,395	113	4.7
June 1972	2,509	131	5.2

Although the percentage of loan defaults at June 30, 1972, is low compared with other HUD multifamily mortgage insurance programs, it may not be indicative of the eventual default rate for section 236 loans because most of the insured loans were relatively new; however, as shown above, the percentage of loan defaults is increasing.

HUD OFFICE OF AUDIT FINDINGS

The HUD Office of Audit disclosed, in addition to the findings noted previously, that:

--Field offices did not have up-to-date and complete cost data to estimate construction costs of proposed projects.

--Field offices' reviews of construction and related costs of completed projects were inadequate. Of 52 field offices, 21 were deficient, which resulted in about $625,000 of ineligible or questionable costs.

--Section 236 program resources, rather than college housing program resources, were used to finance several housing projects intended primarily for college students.

--Nonprofit organizations should be required to have certain minimum assets and should be able to provide working capital as a condition for acceptance as a project owner.

--Numerous projects were on sites that were undesirable for housing because of remote locations, surrounding neighborhoods, or topographical conditions.

Corrective actions taken or planned

HUD, in commenting on the Office of Audit findings, stated that it had revised and strengthened its construction cost review guidelines, particularly those for identifying nonallowable costs. HUD stated further that it was preparing instructions which would help to eliminate the overlap between the section 236 and the college housing programs.

CENTRAL OFFICE TASK FORCE FINDINGS

The task force noted, in addition to the findings mentioned earlier, that:

--Construction cost estimates for proposed projects were poorly documented and usually excessive, and

construction time often was overestimated by 50 to 100 percent.

--Credit analyses of prospective project owners often were incomplete or were not made.

--Reviews of construction and related costs of completed projects were not satisfactory.

--Housing under the sections 235 and 236 programs was approved for construction without regard to the impact it would have on other HUD-subsidized housing in the market area.

--Subsidized projects were often clustered in specific areas, which caused vacancy problems and unfavorable neighborhood distinctions.

These findings were included in a report issued in August 1971. HUD officials told us that, because the Office of Audit's review was underway at that time and because the program areas included in that review were the same areas covered by the task force, HUD had taken no specific actions as a result of the task force report.

CHAPTER 7

SCOPE OF REVIEW

We examined HUD's policies, procedures, and practices in (1) allocating sections 235 and 236 program resources throughout the country, (2) appraising land selected for section 236 projects, and (3) assisting and monitoring the management of projects. We also reviewed the method of financing the program and the various program incentives, to determine whether they were sufficient to bring private capital into the program to meet section 236 objectives.

We made our review at HUD headquarters in Washington, D.C., and at field offices in Atlanta, Dallas, and Los Angeles. In HUD's New York City field office, our review was directed toward HUD's policies, procedures, and practices in assisting and monitoring the management of projects. We interviewed HUD officials, real estate brokers, project owners, and tenants of section 236 projects and examined pertinent legislation, administrative regulations, and records. With assistance from HUD construction engineers and building inspectors from the four field offices, we inspected 518 apartment units in 40 projects for construction quality and project maintenance.

The field offices at which we conducted our review had been authorized at April 28, 1972, to make interest subsidy payments of $88 million a year for section 236 projects and had approved about 69,000 housing units for construction. These interest subsidy authorizations represented 19 percent of the total section 236 authorizations through April 1972.

APPENDIX I

TAX SHELTERS

A number of tax shelters have been provided by 1969 revisions to the Internal Revenue Code to encourage persons to participate in Federal subsidized housing, such as that provided by the section 236 program.

Examples of the potential advantage of several of the tax shelters are presented in the following sections.

ACCELERATED DEPRECIATION

Since 1969 project owners of newly constructed rental housing have been permitted to depreciate the construction costs of such facilities at an accelerated rate using either the double-declining balance method (200 percent of the straight-line rate applied on a declining balance) or the sum-of-the-years-digits method. In comparison, owners of newly constructed nonresidential commercial buildings, using the double-declining balance method, can depreciate those facilities at 150 percent of the straight-line rate applied on a declining balance.

To understand the tax advantage of using the double-declining balance method of depreciation, assume that a residential structure and a nonresidential commercial structure each has a capitalized construction cost of $1 million, an estimated useful life of 40 years, and an estimated residual value of $200,000. During the first 10 years of operations, the owner of a residential structure will be able to deduct substantially more depreciation under the double-declining balance method than the owner of a commercial structure. An illustration of the two methods follows.

	Residential structure using double-declining balance method		Commercial structure using double-declining balance method	
Year	Depreciation for the year	Cumulative	Depreciation for the year	Cumulative
1	$50,000	$ 50,000	$37,500	$ 37,500
2	47,500	97,500	36,094	73,495
3	45,125	142,625	34,740	108,334
4	42,869	185,494	33,437	141,771
5	40,725	226,219	32,184	173,955
6	38,689	264,908	30,977	204,932
7	36,755	301,663	29,815	234,747
8	34,917	336,580	28,697	263,444
9	33,171	369,751	27,621	291,065
10	31,512	401,263	26,585	317,650

APPENDIX I

The depreciation for the residential structure exceeds the amount for the commercial structure by about $84,000 in the first 10 years. The current income tax rates for individuals range from 14 percent to 70 percent. Therefore, if a taxpayer had other income against which he could apply any losses from the added depreciation claimed on the residential structure, the added tax shelter, depending on the owner's tax bracket, would be between $11,760 and $58,800 in the first 10 years. Persons with substantial incomes from other sources would be most interested in such a tax shelter as that offered by the section 236 program.

RECAPTURE OF EXCESS DEPRECIATION IN EVENT OF SALE

The most common alternative to accelerated depreciation is straight-line depreciation, in which the owner of property deducts an equal amount each year for a specified number of years. The difference between the amount of depreciation calculated under accelerated methods and the straight-line method is called excess depreciation. As noted in chapter 5, excess depreciation may be subject to recapture as ordinary income in the event of sale of property, but the provisions for recapture are less stringent for subsidized housing than for nonsubsidized housing.

To understand the advantage of the recapture provisions for subsidized housing, assume the same residential project previously illustrated (see p. 45) was sold at the end of 10 years. Also, to compute the tax advantage, assume that (1) the cost of land was $100,000 which, when combined with the capitalized construction cost, makes the total project cost $1.1 million, (2) the project sales price at the end of the 10th year is $1.2 million, and (3) the excess depreciation (difference between accelerated and straight-line) is $201,263.

The following schedule shows a corporate entity's tax liability on the sale of a subsidized project and a nonsubsidized project.

		Subsidized	Nonsubsidized
Sales price		$1,200,000	$1,200,000
Net cost:			
Cost	$1,100,000		
Less depreciation	401,263	698,737	698,737
Gain on sale		$ 501,263	$ 501,263
Tax computation (note a):			
Gain on sale		$ 501,263	$ 501,263
Excess depreciation subject to recapture at ordinary rates		-	161,010[b]
Amount subject to capital gains tax rate		$ 501,263	$ 340,253
Capital gains		$ 150,379	$ 102,076
Ordinary		-	77,285
Total tax		$ 150,379	$ 179,361

[a]A corporate tax rate of 48 percent was used because this rate was constant regardless of income, whereas personal rates vary from 14 to 70 percent of ordinary income. The current corporate capital gains rate is 30 percent.

[b]Because the unsubsidized rental housing project was held for 120 months (10 years), the amount of excess depreciation treated as ordinary income is reduced by 1 percent a month in excess of 100 months. In this example, 20 percent of the excess depreciation would be treated as capital gains and 80 percent ($161,010) as ordinary income for tax purposes.

The tax liability for a sale after 10 years of ownership is about $29,000 less for subsidized housing than for nonsubsidized housing. However, if an unsubsidized project is held for 16 years and 8 months (200 months), the recapture

APPENDIX I

provisions will no longer be in effect and the tax advantage of the subsidized project will expire.

REHABILITATION COSTS

Rehabilitation expenses may generally be depreciated over a 5-year period for a subsidized housing project, whereas such expenses for a nonsubsidized housing project must normally be depreciated over the remaining useful life of the project. Owners of nonsubsidized housing may use accelerated depreciation methods. To understand the tax advantage, assume a section 236 project incurs rehabilitation expenses of $1 million and has a remaining useful life of 20 years. Using corporate tax rates, the added tax benefits to be derived per year for the 5-year period would be as follows:

Year	5-year depreciation of rehabilitation cost	Regular depreciation of rehabilitation costs using double-declining balance method	Difference	Tax advantage (note a)
1	$200,000	$100,000	$100,000	$48,000
2	200,000	90,000	110,000	52,800
3	200,000	81,000	119,000	57,120
4	200,000	72,900	127,100	61,008
5	200,000	65,610	134,390	64,507

[a]Assuming the corporate tax rate of 48 percent.

An owner of rehabilitated subsidized housing will have expended all rehabilitation costs within 5 years, whereas the owner of rehabilitated nonsubsidized housing will continue depreciating the rehabilitation costs at a lesser amount per year for the 20 years of the project's useful life. This would appear to be an incentive for the owner of the subsidized housing to dispose of his property after 5 years since the tax shelter would have expired. However, the Internal Revenue Code provides that, if a rehabilitated project is sold within 16 years and 8 months of the incurrence of rehabilitation expenses, any excess depreciation claimed (the amount by which accelerated depreciation exceeds regular depreciation) may be subject to recapture as ordinary income. This provides an incentive for owners of rehabilitated projects to retain ownership for more than 5 years.

DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
FEDERAL HOUSING ADMINISTRATION
WASHINGTON, D. C. 20411

ASSISTANT SECRETARY-COMMISSIONER

DEC 11 1972

Mr. B. E. Birkle
Associate Director
United States General
Accounting Office
Washington, D. C. 20548

Dear Mr. Birkle:

This is in reply to your letter of September 28, 1972, transmitting for comment copies of your draft report on "Opportunities to Improve Operations and Reduce Costs in the Section 236 Rental Housing Program." We appreciate receiving the constructive recommendations concerning problems identified in the report, which will be helpful to this Department in developing national solutions in several troublesome and complex areas. Some observations in the report pertain to inadequacies previously identified by HUD, and on which we have already initiated positive action.

Before giving our comments with particular reference to the recommendations in the draft report, I would like to advise that a recent evaluation of Section 236 program costs by HUD, estimates total payments under the program, for the 10-year period ending 1978, at approximately $26 billion. Our evaluation is based on 1,291,000 housing units planned for construction or rehabilitation. Although our evaluation is in preliminary draft form, and long-term costs may be somewhat higher than projected, it appears that the final figure may be substantially lower than the high of $49.2 billion projected in the GAO report.

GAO note: Material has been deleted because of changes to final report.

[See GAO note, p. 50.]

The allocation system presently used provides maximum equity among the 77 HUD field offices. A composite weighted average, reflecting percentage of individual office participation in nationwide totals for such factors as starts in the preceding year, estimated current year starts, market absorption potenial, and occupancy potential is compared with a separately estimated fair share percentage in determining contract authority allocable to each office.

The GAO report correctly points out that contract authority within the jurisdiction of a given field office is not distributed to the various counties, SMSA's, or other areas strictly and solely according to estimated need; however, need, although important, is really only one of a number of important criteria used by HUD offices to evaluate proposed projects under HUD's Project Selection Criteria. Included among other significant factors are improved location, relationship to orderly growth and physical environment, and adequacy of proposed management. These are factors considered in determining which projects are to receive reservations of contract authority as well as the order in which such projects are to be funded. A poor rating in any of the criteria is sufficient for disqualification of the project.

The report correctly points out that some communities with market need that could be served by the Section 236 program are not utilizing or not fully utilizing this resource. The report also indicates that HUD offices have not attempted to stimulate construction or rehabilitation of housing under Section 236 in such areas.

HUD has never taken the position that it can allocate contract authority to each individual area exactly in ratio to the need for housing in that market area in comparison with other areas. HUD does not initiate housing production, nor do we believe that the Department should attempt to force housing development in any area. We do see merit in efforts to inform industry and communities on the benefits of the Section 236 program, and have been doing this. We are considering development of a more intensive effort which might be used to stimulate productivity where it is most appropriate. Many conditions influence housing production in a given area. Included are: the quality and availability of builders; the willingness of financial institutions to participate; resistance on the part of local communities to the housing of lower income families; lack of permissive zoning, and so on.

APPENDIX II

In support of allocations of contract authority to regional offices, FHA market analyses have long provided the most accurate data available on housing needs. This information together with knowledge of regional and local conditions has formed the basis for national allocation decisions.

The ratio of Section 236 subsidy funds applied to housing needs in the central city has been higher than the ratio of Section 236 applied to housing needs in the suburbs. This tendency has existed in virtually every federal assistance program in recent years. Part of the reasons for this are the facts that, at the outset of the 236 program, central city needs seemed more real and more urgent. FHA offices were centrally located, and sponsors and activists were formed in well-organized, urbanized areas.

HUD does not initiate assisted housing projects and although it must approve sites, it cannot select them. Through the "fair share" effort we are expanding the geographical reach of the 236 program. This system assigns values to demand, supply, and locational factors in a way which encourages both public agencies and private builders to shift attention from jurisdictions whose needs have been met, or nearly met, to those with greater need.

The Project Selection Criteria system, made effective in February 1972, is expected to have a significant effect on locational decisions. In support of these criteria, HUD field offices have received instructions prohibiting funding of proposals primarily on a "first come first served" basis. (HPMC-FHA 4400.47 dated March 6, 1972). In the end, the Project Selection Criteria will go far to meet the problems on resource allocation identified in the GAO report.

[See GAO note, p. 50.]

The GAO report indicates that HUD Land Valuations exceeded the acquisition cost of the land by the sponsor in 47 of 68 Section 236 projects reviewed.

The HUD valuation is concerned with Fair Market Value of Land Fully Improved. HUD instructions require that the appraiser when estimating the value of the land treat any required off-site improvement, demolition, or unusual land improvement as though the work were already completed.

[See GAO note, p. 50.]

If HUD appraisal instructions, which are based upon sound appraisal principles and practices, are followed there should be little concern for the possibility of windfall profits on the land.

We agree with the need to effectively monitor field office practices to insure that outstanding instructions are being followed. As to the adequacy of the instructions, whatever shortcomings that have been encountered in land appraisals have, without exception, been due to a faulty appraisal and not to deficiencies in the instructions or procedures. Eliminating the possibility of providing at least some part of the equity by a legitimately incurred and documented appreciation of the land cannot be supported. HUD must consider the market value of the land, assuming a proper appraisal, otherwise the prudent landowner will pursue the highest and best use of his land in developing it in a way which does recognize true market value.

If a developer is astute, and acquires land for his project early and at a favorable price, it would be punitive to consider his acquisition cost and not the higher actual, fair market value when HUD processes the case. If such a developer chose to, he could sell his land to another sponsor at fair market value, and HUD then would have to consider market value in processing a new application. HUD must consider market value of land in the same way that we consider value of labor and materials.

[See GAO note, p. 50.]

Unquestionably, this is an important area, and HUD has re-evaluated previous monitoring procedures with the following

corrective measures having been taken:

1. Circular HM 4381.2, "Management Requirements in Processing Insured Multifamily Housing Projects" has been issued which requires a preoccupancy conference to instruct owners in requirements for subsidized tenant admission and continuing residency. In addition, this issuance sets forth the requirement for an on-site HUD team review of tenant recertifications and income verifications.

2. Circular HM 4442.22, "Section 236 Program Annual Recertification of Income Eligibility," dated September 26, 1972, prescribes recertification of tenant incomes at least annually in contrast to the previous requirement calling for biennial recertification. This directive also requires a review by the HUD field office of 100 percent of the initial certification and at least 15 percent of the recertifications.

3. A circular has been issued establishing a variable minimum income limit for initial admission to Section 236 projects. Among the purposes of this circular is to increase the percentage of tenants receiving less than maximum subsidy thereby enhancing the economic viability of the projects, and at the same time, increasing the potential number of families in need of assistance that might be served.

The recently authorized increase in Field Office staff is expected to provide the manpower needed to implement in depth the directives that have been issued to improve operations and reduce costs in the Section 236 program.

In addition to the new requirement for more frequent recertifications, HUD has initiated a series of Rental and Occupancy Workshops in five Regional Office cities during the remainder of the current fiscal year. The purpose of these workshops is to familiarize Area and Insuring Office personnel with the requirements of the various subsidized housing programs and to impress upon the field office staff the importance of their reviews and supervision of management in Section 236 and Rent Supplement projects.

As a result of these workshops, it is expected that HUD personnel will be better able to monitor the activities of project managers and maintain a closer surveillance of adherence to admission and occupancy standards, rent collections and remittance of excess rents, and unit-size assignments as well as increasing responsibilities for review of income certifications, recertifications and verifications.

Recommendation 4. - The GAO report recommends that the Government could achieve sizeable savings in Section 236 program costs if mortgage loans were financed by the Government rather than by private lenders. A similar point also was made in your report on the Section 235 program.

Whether it is in the public interest for HUD to enter the mortgage banking business is a rather broad and basic question. If it is to be pursued further, I assume that the Office of Management and Budget will coordinate recommendations from the Executive Branch.

We discussed the matter of direct funding in considerable depth in our response to the GAO report on the Section 235 program, and refer you to that for the Department's further views on the matter.

Recommendation 5. - The GAO report contends that incentives provided to profit-motivated entities to invest in Section 236 projects are sufficient to initially attract a substantial number of prospective sponsors but do not appear adequate to encourage long-term ownership of projects.

[See GAO note, p. 50.]

The various incentives to investment, such as the use of loan proceeds applicable to builder-sponsor profit and risk allowance to meet equity requirements and particularly the provisions for favorable tax treatment, have influenced significantly the motivation of limited-dividend sponsors. Some degree of imbalance may exist between production incentives and long-term retention or management incentives due to these special tax provisions, which are apparently attractive enough to offset an otherwise unimpressive yield to the investor limited to 6%. There appears to be little tax incentive to continue ownership after the initial 10-year period. While it may be desirable to encourage retention of projects by original owners, the essential factor is good management, regardless of ownership. HUD exercises substantial control over the selection of project management and its management program. Through regulatory agreements, we also influence management decisions to assure successful projects. The crucial point is not whether a well-managed project changes ownership after 10 years or at any time, in fact, but whether sound management continues. We believe that a project, which has reached its 10th anniversary--one-fourth of the way through the mortgage life--represents one of HUD's best and most successful investments.

If it is assumed that ownership and management will in the future continue to share an identity of interest, as they do now to a large extent, the concern with ownership has some validity. However, the measures being taken to promote the establishment of an independent, specialized, skilled, and competent housing management industry should lessen such concern. In any case, development of retention or management incentives should be stressed, rather than the reduction or shifting of production incentives. We plan to look into this possibility in depth.

Other GAO Observations

Comments were made by the GAO report on the subjects of inadequate cost certification, outdated data books, inappropriate use of Section 236 funds for college housing, financial weakness of nonprofit sponsors, and approval of undesirable sites.

HUD has already responded by revising guidelines intended to strengthen the cost certification process, particularly with regard to nonallowable costs. A potential overlap may occur between Section 236 and the college housing program only in those cases where, in the absence of sufficient general market demand, sponsors have included college students in support of applications. The new Section 236 Handbook, now in final draft form, eliminates this by requiring that there be a market for the Section 236 project exclusive of student use, although eligible students may not be excluded from tenancy in the projects.

The GAO report also observed that fees for legal and organizational expenses were higher in Dallas than those fees suggested by HUD Guidelines. This observation is correct. Dallas is unusual in the degree to which it departs from the guidelines for legal and organizational fees. Pursuant to the HUD decentralization policies, the responsibility in this regard rests with Area Office Directors and Regional Administrators. The Department will follow-up on this matter.

While determining that the quality of housing produced under Section 236 is generally "good," the GAO report noted that actual operating costs of projects were found to vary rather substantially from estimated costs. GAO believes this underestimation to be the result of outdated and incomplete cost data. To help correct this problem, HUD issued a guideline (HPMC-FHA 4442.3A, Change 1, April 10, 1972) which requires that estimates be documented by the inclusion of actual costs from at least three similar projects and that significant variances between the estimates for a specific project and cost experience on similar projects be explained. We agree that particular attention must be directed to the issue of operating expenses, and that HUD field offices make use of the latest current data to the greatest degree possible.

The GAO report is a sound presentation and certain of its observations and comments touch on some of the most troublesome and complex issues of this day. Concerning these, HUD is devoting considerable resources and effort. The constructive GAO comments are being added to our equations as we move toward meeting national housing goals in the best way possible.

Sincerely,

Eugene A. Gulledge

APPENDIX III

OFFICE OF THE SECRETARY OF THE TREASURY
WASHINGTON, D.C. 20220

November 10, 1972

Dear Mr. McAuley:

This is in reply to your letter of October 3, 1972 to Secretary Shultz requesting comments on chapters 5 and 6 of your draft report, "Opportunities to Improve Operations and Reduce Costs in the Section 236 Rental Housing Program -- Department of Housing and Urban Development."

Draft chapter 5 concludes that the costs to the Federal Government under the section 236 rental housing program could be substantially reduced if HUD were authorized to make loans with funds borrowed by the Treasury, rather than the existing method of financing the program by insured loans made by private lenders. The draft chapter recommends that Congress consider amending the legislation pertaining to the section 236 program to require that the mortgage loans be financed by the Government.

The conclusion, recommendation, and technical analysis contained in draft chapter 5 are essentially the same as those in chapter 6 of your earlier draft report on the section 235 homeownership assistance program on which I provided detailed comments in my letter to you of June 7, 1972. As indicated in that letter, we believe that the methods of financing Federally guaranteed and insured obligations in the private market should be subject to overall review and coordination as proposed by the Secretary of the Treasury in the Federal Financing Bank Act.

Keep Freedom in Your Future With U.S. Savings Bonds

A major conclusion from draft chapter 6 is that the various tax incentives may encourage investors to turnover properties. It is not at all clear that the tax incentives have this effect. Investment analysis suggests that in many cases investors would be better off not selling and possibly mortgaging out.

High turnover is only a problem if it leads to external costs such as neglect of repair and maintenance. The argument that there are such external costs is not fully convincing and has not been documented in the draft report. "Fast buck" operators cannot neglect the potential sale price which in turn depends on past maintenance and repairs.

The draft report seems to imply that the goal of real estate investors is to minimize taxes. For example, the report implies that investors will hold properties until they can get out from under the recapture rules. However, it should be recognized that a decision based on minimizing taxes will not necessarily maximize after-tax returns.

It does seem that there are a number of problems associated with a direct subsidy program which depends on tax incentives to make it go. The supposed advantage of tax incentives that they involve less red tape than direct subsidies surely does not apply here where the tax incentive is coupled to a direct subsidy.

[See GAO note.]

GAO note: Material has been deleted because of changes to final report.

APPENDIX III

[See GAO note, p. 59.]

Sincerely yours,

Jack F. Bennett

Jack F. Bennett
Deputy Under Secretary
for Monetary Affairs

Mr. Charles P. McAuley
Assistant Director
U.S. General Accounting
Office
Treasury Annex Building
Washington, D.C. 20548

APPENDIX IV

EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET
WASHINGTON, D.C. 20503

NOV 20 1972

Mr. Henry Eschwege
Director, Resources and
Economic Development
General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in response to your request of September 29, 1972, for the views of the Office of Management and Budget regarding Chapter 5 of General Accounting Office draft report on Opportunities to Improve Operations and Reduce Costs in the Section 236 Rental Housing Assistance Program. In Chapter 5 GAO discussed its finding that the program cost (interest subsidies) would be reduced if HUD financed the capital costs of the Section 236 program with Treasury borrowings rather than rely on private lenders as is presently required by statute.

The Section 236 proposal is identical to an earlier GAO recommendation to use direct Federal lending for financing housing assisted under the Section 235 Homeownership Assistance Program. Mr. Weinberger advised you of our general opposition to the Section 235 proposal in his letter of August 5, 1972.

The concerns spelled out in our earlier correspondence are fully applicable to the present proposal for Section 236. In summary, the uncertain cost savings of a direct loan program do not justify the Federal takeover of this portion of the housing mortgage market, particularly when this part of the market appears to be adequately served by existing institutions and patterns of lending.

Sincerely,

Paul H. O'Neill

Paul H. O'Neill
Assistant Director

APPENDIX V

PRINCIPAL OFFICIALS OF THE DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT RESPONSIBLE FOR THE ADMINISTRATION OF ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office From		To	
SECRETARY OF HOUSING AND URBAN DEVELOPMENT:				
Robert C. Weaver	Feb.	1961	Dec.	1968
Robert C. Wood	Jan.	1969	Jan.	1969
George W. Romney	Jan.	1969	Present	
ASSISTANT SECRETARY FOR HOUSING PRODUCTION AND MORTGAGE CREDIT (formerly Assistant Secretary-Commissioner, Federal Housing Administration) (note a):				
Philip N. Brownstein	Mar.	1963	Feb.	1969
William B. Ross (acting)	Feb.	1969	Sept.	1969
Eugene A. Gulledge	Oct.	1969	Present	
ASSISTANT SECRETARY FOR HOUSING MANAGEMENT:				
Lawrence M. Cox	Mar.	1969	July	1970
Norman V. Watson	July	1970	Present	

[a] In February 1970 the responsibility for section 236 housing management functions was transferred to the Assistant Secretary for Housing Management.

PHOTOGRAPHS SHOWING EXAMPLES OF
DEFECTS IN HOUSES PROVIDED BY HUD
AND USDA UNDER THE SECTIONS 235 AND 502 PROGRAMS

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

House in dilapidated condition with unsafe stairs, missing roof shingles, peeling paint, and missing crawl space cover, Seattle, Washington

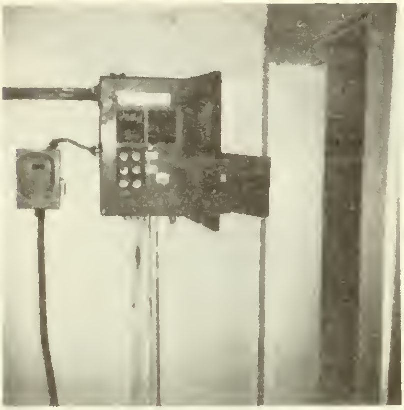
Unsafe fuse box, with exposed wiring, located in kitchen, Seattle, Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

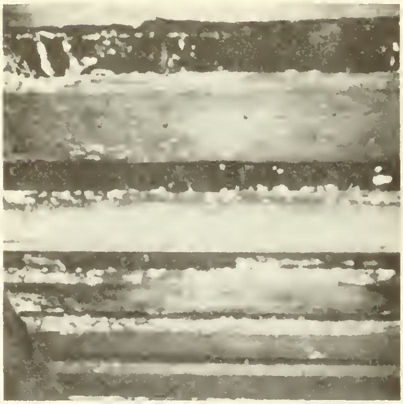
Inoperable bathroom sink blocking a portion of window, Seattle, Washington

Large crack in living room wall near deteriorated window sill, Seattle Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD



Defective electrical wiring between fuse boxes, Seattle, Washington



Rafters rotting as a result of leak in roof, Seattle, Washington

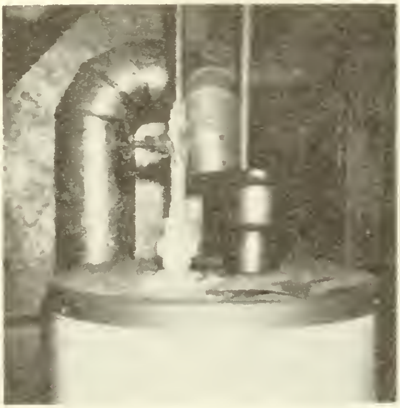
DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Unsafe basement stairs, with rotted steps and support structure. Denver, Colorado

Uncapped gas line with shut-off valve which could be easily opened by small children in home, Commerce City, Colorado

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Sewer line vented into basement bedroom closet; poisonous sewer gas could seep into entire basement. Commerce City, Colorado



Unattached flue and corroded water inlet pipe on gas water heater. Commerce City, Colorado

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Exposed fuses and electrical wiring, Salt Lake City, Utah

Structural defect-brick wall cracked both below and above window. Washington, D. C.

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Deteriorated exterior walk and house foundation, Washington, D. C.

Water stains on kitchen ceiling resulting from roof leaks; exposed pipe. Washington, D. C.

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Paint peeling on kitchen walls,and exposed pipes, Washington, D. C.

Cracked and dilapidated exterior door, Washington, D. C.

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Plaster cracked and separating from bathroom wall, Washington, D. C.

Broken and missing floor tiles in kitchen, Washington, D. C.

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Uncapped electrical junction box with exposed wires. Washington, D. C.

Dilapidated exterior basement door; water drained into basement through large gap at bottom of door. Alexandria, Virginia

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Damage to first floor ceiling resulting from defective plumbing, Alexandria, Virginia

Rotted exterior door, Lancaster, Texas

DEFECTS IN EXISTING HOUSES PROVIDED BY HUD

Badly weathered wood siding with metal patches; clothes washing machine installed outdoors. Garland, Texas

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Uncovered area between first floor and basement with exposed electrical wiring. Chehalis, Washington

House in dilapidated condition; note lack of gutters and downspouts and peeling paint. Chehalis, Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Delapidated porch; note lack of gutters and warped door
Montesano, Washington

Additional evidence of deteriorating condition of house shown in preceding photograph; note rotting window sill and sash and rusted downspout, Montesano, Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Example of poor workmanship in painting and repairing used house; note unprofessional paint job and unfinished carpentry, Montesano, Washington

Additional evidence of poor workmanship in painting and repairing used house shown in prece~~e~~ding photograph, Montesano, Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Safety hazard; delapidated and rotting steps, McCleary, Washington

Safety hazard; substandard electrical fixture; also roof leaked around chimney, McCleary, Washington

DEFECTS IN EXISTING HOUSES PROVIDED BY USDA

Floor joists spaced more than 4 feet apart; standing water in crawl space, Arlington, Washington

Interior of house in delapidated condition; note wire in hole in wall and lack of hardware on door, Omak, Washington

DEFECTS IN NEW HOUSES PROVIDED BY HUD

Improper grading resulted in water draining into crawl space; at time of inspection there was 6 inches of water under this house. Lynnwood, Washington

Fire hazard; opening in closet ceiling around flue should have been fireproofed, Colorado Springs, Colorado

DEFECTS IN NEW HOUSES PROVIDED BY HUD

Structural defect; large crack in front of house caused by improper foundation, Mesquite, Texas

Interior flooring of house shown in preceding photograph, Mesquite, Texas

DEFECTS IN NEW HOUSES PROVIDED BY USDA

Improper grading resulting in water ponding, Marysville, Washington

Discoloration of bathroom floor resulting from using improper type of adhesive, Marysville, Washington

DEFECTS IN NEW HOUSES PROVIDED BY USDA

Water heater located in attic without pressure release valve connected to outside and no device to handle water overflow, Marysville, Washington

Improper grading and unfinished back yard, Mt. Vernon, Washington

DEFECTS IN NEW HOUSES PROVIDED BY USDA

Improper grading resulting in water draining into crawl space. Mt. Vernon, Washington

Inadequate site preparation resulting in erosion--retaining wall is needed. Redmond, Washington

DEFECTS IN NEW HOUSES PROVIDED BY USDA

No finished flooring material installed over subfloor; note also hole in bedroom floor through which rodents could enter, Redmond, Washington

Inadequate site development resulting in erosion around foundation, Redmond, Washington

DEFECTS IN NEW HOUSES PROVIDED BY USDA

Unsafe railing; note also need for step due to height of porch. Redmond, Washington

Improper grading resulting in water ponding next to foundation. Marysville, Washington

DEFECTS IN NEW HOUSES PROVIDED BY USDA

Improper grading resulting in inadequate drainage, Marysville, Washington

Chairman PROXMIRE. Now, we would like to hear from Lawrence Katz, former Director, FHA, Milwaukee, Wis., Philip Brownstein, former Commissioner of the Federal Housing Administration, and Walter L. Smart, Executive Director, National Federation of Settlements and Neighborhood Centers. Would you come forward?

Gentlemen, the hour is late and I do not want to impose on you any longer than necessary. We do have a rule that we have the oral presentation confined to 10 minutes, and your prepared statement, which is in most cases longer than that, will be incorporated in full in the record. If you want to abbreviate your prepared statement to less than 10 minutes, of course, that is acceptable, too. We would like to have a chance to ask questions and we are getting along, and we do not want to detain you too much after the noon hour.

Mr. Katz, why do you not go ahead and we will go right across the board.

STATEMENT OF LAWRENCE S. KATZ, FORMER DIRECTOR, FEDERAL HOUSING ADMINISTRATION OFFICE, MILWAUKEE, WIS.

Mr. KATZ. Mr. Chairman, and members of the subcommittee, you have heard, and will continue to hear, testimony on the issue before you from many people. Most will be those who have participated in the housing field from the central Washington viewpoint, or have been involved in the academic study of housing and the urban problem.

I speak from neither viewpoint, but from one who has worked in this area from the vantage point of field operations. For almost a decade, I headed the Wisconsin office of the Federal Housing Administration and, late last year, joined the Midland National Bank of Milwaukee as its vice president for urban affairs and financing. As a result of my previous experience and current position, I was asked by Secretary Romney early this year to serve as his personal consultant in the area of housing defaults and counseling. I have been appointed Chairman of the Wisconsin Housing Finance Authority, currently in the process of organization, and involved in floating a bond issue of $150 million for mortgage financing.

Between 1962 and 1971, as FHA Director, I experienced all of the problems that urban-oriented FHA offices were confronted with around the Nation—the original redlining of inner city areas as Government policy; impaction, poverty, and white apathy; the hurried and almost frantic demands by Washington officialdom in 1968 to respond to the pressures that were emanating from the black ghettos of the large urban communities, including Milwaukee, where we saw continuous street demonstrations and marches by Father Groppi and his followers protesting housing conditions; the 1968 housing legislation by Congress aimed at improving housing conditions in the core areas of the large cities; the national and regional meetings of FHA and HUD personnel after that period of time, and through 1971, spelling out further involvement and further response by Government to improve housing throughout the Nation.

To some of us charged with responsibility of implementing these programs on a local level, it was quite apparent that errors were being made and risks being increased. I suspect that one of the reasons I

have been asked to appear before you is due to my experience with these programs in the Wisconsin jurisdiction. In that State, FHA was heavily involved in subsidized single and multifamily housing. In the late sixties, 25 percent of all of the single family underwriting in the State of Wisconsin was in the core area of Milwaukee, a heavily impacted central city consisting of approximately 8 square miles, with 100,000 blacks—probably the most impacted black area in the United States. Statistics will show that at the end of 1971, there were only 29 defaults under section 235 in the entire State. No multifamily subsidized housing has come back to the Government through foreclosure in Wisconsin, or, for that matter, unsubsidized housing as well. By the end of 1971, 850 welfare mothers receiving aid to dependent children, had become homeowners in Milwaukee's central city with others in other cities in the State. Only two homes came back to HUD. It is out of this background and results that I make just a few observations in the few minutes allotted to me. There is much one could talk about, but time precludes.

The subsidy programs, particularly sections 236, 235 and 221(d)(3) rent supplement, are basically sound, and have produced a significant amount of good housing at a reasonable price. They came into being in a moment of time (1969–70) when inflationary factors precluded the purchase of a new modest home by the wage earner earning \$7,000–\$9,000 per year. This wage earner's counterpart, 10 and 15 years prior to that, was able to purchase a modest new home out of his then earnings of \$4,500–\$6,500 per year. In those days, his mortgage payments were approximately \$125 for interest, principal, taxes, and insurance. Ten years later, the home that he was able to buy previously at \$14,500–\$18,000 was now \$24,000, with monthly payments of approximately \$250. Higher interest and higher taxes, together with some increase in construction costs, caused this result. For some time in the late sixties, new construction was out of his reach. He could only purchase existing older units, vacated through the upgrading process.

The same set of circumstances faced the renter, and 236 assistance helped solve the problem of the aged, the young couple with their first job, and the families with children who needed a rental townhouse. The 235 and 236 programs served those of moderate means—not low income. The rent supplement program, providing a subsidy amounting to 60 percent of the total rent, when necessary, served the poor. It produced rents equivalent to those asked in public housing and for property that paid full taxes. Throughout Wisconsin, this housing was built, and visually as well as structurally, a credit to the communities in which they exist.

In Milwaukee, two-thirds of all multifamily subsidized housing under section 236 and 221(d)(3) rent supplement was built outside of the central city—usually around the perimeter of the city itself. One-third was and is being built in the central city, serving primarily the black community. Throughout Wisconsin, all subsidized housing fares well—no vacancies and no economic problems. What is important is that at the right time the housing supply was increased with good housing—at a price renters could afford.

The same is true of housing that has served to help buyers under section 235. Small towns, medium-sized towns, and large cities have

seen this housing built and, with just a few exceptions, it has been accepted. The housing in most cases cannot be distinguished from housing being built for those who do not need a subsidy. Occasionally, there have been problems with construction, but I suspect no greater than the problems that exist in new construction built for nonsubsidized buyers.

Yes, the programs can be improved; there can be consolidation of subsidized programs within HUD; but I strongly believe these programs should continue to encourage the construction of new housing in areas of need within the present framework of government involvement.

I would further encourage experimentation of cash assistance to buyers and renters; but I do believe that a cash housing assistance program would only be successful in those areas where there is an abundance of available housing for rent or for sale. A cash assistance program would not work out in Milwaukee's southside, for example, where there is a serious shortage of housing—very little for rent—and very little for sale at a moderate price. The private sector could react with more construction if it knew there were more renters and buyers, of course. The significant question, of course, is would they react with the kind of housing that would fulfill the total demand? I know the industry well. I came from it myself. If there is demand for housing as a result of a cash assistance program, and this demand was among the elderly and young couples, and couples with a number of children, what do you think the builder would build in the way of rental housing? Without a doubt, he would build for the elderly—for those without a serious management problem. He would be free to choose the kind of construction he would be involved in, and you may be sure it would not be family housing for rent.

Today, Government, in its public housing programs, as well as its HUD–FHA programs, encourages the production of balanced housing—that is, if housing is to be built for the elderly, there is a demand that housing for families also be built. This kind of thoughtful planning would be absent in a cash assistance program.

What is necessary is the awareness that Government programs are no better than the ability to properly administer, and that it is quite essential in the administration that the training of personnel in the processing functions should be as intense, if not more so, than training in the program functions of HUD.

In the process of decentralizing HUD, it appears that there has been a lack of training of additional new personnel for expanding functions and to replace those who are leaving due to retirement or other jobs. There is a significant lag in the delivery of housing through HUD due to this insufficiency. Lack of training does result in the lack of quality underwriting and will result in abuses that no amount of legislation or regulations can avoid.

In the judgment area, it is obvious that there must be a division between quality of legislation and quality of personnel. We currently suffer significantly in the area of sufficient qualified personnel in the field offices.

This committee is obviously concerned with economies in housing. Whatever is done by Government to provide housing for the poor and

low income is going to cost money—a great deal of it. The obvious problem confronting all, is to use this money wisely and well. All of us who have worked in this field, particularly away from the central office, have seen waste. One area of waste that I have long deplored is that in public housing. It is difficult to understand the placement of a highrise building in a small community—and there are many such—that house one-bedroom and efficiency apartments for the elderly. It can be five to 12 stories high. It is the only highrise building in the entire small community. Land in these communities is quite cheap. It is common knowledge in the construction industry that once you go above the third floor, you go to a heavier type of construction, that is, steel or reinforced concrete—and the cost per square foot increases by 50 percent.

Why do the public housing people in HUD continue to encourage this type of construction for people who in all of their lives never lived above the second floor? Without a doubt, for the same dollars, we could produce one-third again as many apartments if we went to low rise construction. There may be justification for high rise construction in large urban communities where land near necessary amenities is scarce and expensive, but certainly not in cities with populations of 200, 5,000, or even 10,000.

The other area of concern is sale housing for the poor. It has been quite popular in recent years to encourage the poor to purchase their homes. We talk about private homeownership. In Milwaukee we have housed over a thousand welfare families as of today, that is, welfare mothers receiving aid to dependent children, in homes of their own. In addition, thousands of poor families are buying good, rehabilitated homes with the male head—a wage earner—obtaining either a subsidy under 235, or none because of his earnings. These programs have been pursued in other communities and HUD is increasingly striving to deliver the best possible rehabilitated home to these low-moderate income buyers. Predictably, this program too, will fail, because no provision is being made for the dollars necessary to spend for significant major repairs and maintenance that will inevitably occur, no matter how well the older home is currently rehabilitated, gentlemen, the do-it-yourself skills are significantly absent among the poor and low-moderate income buyer in the central cities.

I taught a graduate course in the University of Wisconsin this past spring, two blacks were in that class. the one black reported that he had been going around looking for a 235 home, father of three children, and he saw 20 homes occupied by white families for sale. He said, "Mr. Katz, one of the outstanding things I saw which epitomizes the difference between a white community and the black community is that in every one of these homes I saw a work bench in the garage or basement." He says, "We have never seen this in a black home, the best we had was a rusty tool pail in a barn." This emphasizes the lack of skills in the black community, of skills that are taken for granted in the white community. So these do-it-yourself skills are significantly absent among the poor and low-moderate income buyer in the central cities. Budget skills are also absent, and even if present, it becomes most difficult on meager earnings to put sufficient dollars aside to repaint the entire house when necessary—and it will be necessary within

a few years; to make major carpenter repairs to front and rear porches or both, and that, too, will be necessary; a new roof, or a new furnace in due time. This kind of savings program involving hundreds of dollars is most difficult to launch and to maintain. The pressures for these dollars for immediate family needs will preclude this kind of saving program among many. The result is that today's well rehabilitated homes will come back to HUD in spite of all its precautions currently to do the best possible underwriting job. Unless we solve this problem which involves major counseling efforts and more, we will be confronted with acquisitions and massive financial losses far exceeding anything we have experienced up to now.

I am convinced that many of the low-income families currently buying homes in our central cities—if given the alternative—would prefer renting. Many are buying because they have no choice. There are no rental units available that will house a sizable family. We desperately need more rental housing in the central cities, as well as scattered site housing for these families. The answer for these families is not cash allowances, for this would be another welfare approach—instead we need more and more and more new construction.

The subsidy housing programs we have experienced for over a decade have proven their worth—they do need revision and improvement and simplification. There is a need for some reduction in what I call "water" in the cost of replacement of FHA–HUD multifamily housing. There can be elimination of some fees and charges that serve only to inflate rents. The philosophy that encouraged and resulted in almost 100-percent financing for subsidized projects in the early sixties is not valid today. It may be possible it was not even valid then. It is possible that it was not valid even then, but it was done. The limited distribution sponsor who obtains a 90-percent mortgage on cost of replacement—in reality does obtain 100-percent financing. As part of the cost of replacement, we include a builders and sponsors profit and risk allowance which amounts to 10 percent of the total cost of the project except for land. Using this for a credit against his 10 percent equity requirement, together with a 2-percent allowance as builders general overhead, not cost certifiable, he ends up with 100-percent financing. The same advantages and financing are available under Section 221(d)(4), an unsubsidized program.

Chairman Proxmire. Larry, this breaks my heart. You are one of the first witnesses I have had for a long time who is one of my bosses; a Wisconsin voter and, I have to cut you off. Let me put it this way, can you give us your recommendations and we will put the entire prepared statement in the record.

Mr. Katz. Now——

Chairman Proxmire. Give your recommendations.

Mr. Katz. My recommendation, among other things, is continuation of a subsidy program for new construction, a reduction in fees allowed in multifamily construction, I have outlined them, and a rebuilding of the central city without high-density new construction. Instead let's do it with low-density new construction which we have done and done successfully. That is it, Mr. Chairman.

(The prepared statement of Mr. Katz follows:)

Prepared Statement of Lawrence S. Katz

Mr. Chairman and members of the subcommittee: You have heard and will continue to hear testimony on the issue before you from many people. Most will be those who have participated in the housing field from the central Washington viewpoint, or have been involved in the academic study of housing and the urban problem.

I speak from neither viewpoint, but from one who has worked in this area from the vantage point of field operations. For almost a decade I headed the Wisconsin Office of the Federal Housing Administration and late last year joined the Midland National National Bank of Milwaukee as its Vice President for Urban Affairs and Financing. As a result of my previous experience and current position, I was asked by Secretary Romney early this year to serve as his personal consultant in the area of housing defaults and counseling. I have been appointed Chairman of the Wisconsin Housing Finance Authority, currently in the process of organization.

Between 1962 and 1971, as FHA Director, I experienced all of the problems that urban oriented FHA offices were confronted with around the nation—the original red-lining of inner city areas as government policy; impaction, proverty and white apathy; the hurried and almost frantic demands by Washington officialdom in 1968 to respond to the pressures that were emanating from the black ghettos of the large urban communities, including Milwaukee, where we saw continuous street demonstrations and marches by Father Groppi and his followers protesting housing conditions; the 1968 housing legislation by Congress aimed at improving housing conditions in the core areas of the large cities; the National and Regional meetings of FHA and HUD personnel after that period of time and through 1971, spelling out further involvement and further response by government to improve housing throughout the Nation.

To some of us charged with responsibility of implementing these programs on a local level, it was quite apparent that errors were being made and risks were being increased. I suspect that one of the reasons I have been asked to appear before you is due to my experience with these programs in the Wisconsin jurisdiction. In that state FHA was heavily involved in subsidized single and multifamily housing. In the late 60's, 25% of all of the single family underwriting was in the core area of Milwaukee, a heavily impacted central city consisting of approximately 8 square miles, with 100,000 blacks—probably the most impacted black area in the United States. Statistics will show that at the end of 1971, there were only 29 defaults under Section 235 in the entire state. No multifamily subsidized housing has come back to the government through foreclosure in Wisconsin. By the end of 1971, 850 welfare mothers receiving aid to dependent children, had become home owners in Milwaukee's central city. Only 2 homes came back to HUD.

It is out of this background and results that I make just a few observations in the few minutes allotted to me. There is much one could talk about, but time precludes.

The subsidy programs, particularly Sections 236, 235 and 221(d)(3) rent supplement, are basically sound and have produced a significant amount of good housing at a reasonable price. They came into being in a moment of time (1969–1970) when inflationary factors precluded the purchase of a new modest home by the wage earner earning $7000–$9000 per year. This wage earner's counterpart ten and fifteen years prior to that was able to purchase a modest new home out of his then earnings of $4500–$6500 per year. In those days his mortgage payments were approximately $125 for interest, principal, taxes and insurance. Ten years later, the home that he was able to buy previously at $14,000–$18,000 was now $24,000, with monthly payments of approximately $250. Higher interest and higher taxes, together with some increase in construction costs, caused this result. For some time in the late 60's, new construction was out of his reach. He could only purchase existing older units, vacated through the upgrading process.

The same set of circumstances faced the renter and 236 assistance helped solve the problem of the aged, the young couple with their first job, and the families with children who needed a rental townhouse. The 235 and 236 programs served those of moderate means—not low-income. The rent supplement program, providing a subsidy amounting to 60% of the total rent, when necessary, served

the poor. It produced rents equivalent to those asked in public housing and for property that paid full taxes. Throughout Wisconsin, this housing was built, and visually as well as structurally, a credit to the communities in which they exist.

In Milwaukee, two-thirds of all multifamily subsidized housing under Section 236 and 221(d)(3) rent supplement was built outside of the central city—usually around the perimeter of the city itself. One-third was and is being built in the central city, serving primarily the black community. Throughout Wisconsin, all subsidized housing fares well—no vacancies and no economic problems. What is important is that at the right time the housing supply was increased with good housing—at a price renters could afford.

The same is true of housing that has served to help buyers under Section 235. Small towns, medium sized towns, and large cities have seen this housing built, and with just a few exceptions, it has been accepted. The housing in most cases cannot be distinguished from housing being built for those who do not need a subsidy. Occasionally there have been problems with construction, but I suspect no greater than the problems that exist in new construction built for non-subsidized buyers.

Yes, the programs can be improved; there can be consolidation of subsidized programs within HUD; but I strongly believe these programs should continue to encourage the construction of new housing in areas of need within the present framework of government involvement.

I would further encourage experimentation of cash assistance to buyers and renters; but do believe that a cash housing assistance program would only be successful in those areas where there is an abundance of available housing for rent or for sale. A cash assistance program would not work out in Milwaukee's south side, where there is a serious shortage of housing—very little for rent—and very little for sale at a moderate price. The private sector could react with more construction if it knew there were more renters and buyers. The significant question of course is, would they react with the kind of housing that would fulfill the total demand? I know the industry well. I came from it myself. If there is demand for housing as a result of a cash assistance program, and this demand was among the elderly and young couples, and couples with a number of children, what do you think the builder would build in the way of rental housing? Without a doubt, he would build for the elderly—for those without a serious management problem. He would be free to choose the kind of construction he would be involved in and you may be sure it would not be *family* housing for rent.

Today Government, in its Public Housing programs, as well as its HUD–FHA programs, encourages the production of balanced housing—that is, if housing is to be built for the elderly, there is a demand that housing for families also be built. This kind of thoughtful planning would be absent in a cash assistance program.

What is necessary is the awareness that Government programs are no better than the ability to properly administer and that it is quite essential in the administration that the training of personnel in the processing functions should be as intense, if not more so, than in the program functions of HUD.

In the process of decentralizing HUD, it appears that there has been a lack of training of additional new personnel for expanding functions and to replace those who are leaving due to retirement or other jobs. There is a significant lag in the delivery of housing through HUD due to this insufficiency. Lack of training does result in the lack of quality underwriting and will result in abuses that no amount of legislation or regulations can avoid.

In the judgment area, it is obvious that there must be a division between quality of legislation and quality of personnel. We currently suffer significantly in the area of sufficient qualified personnel in the field offices.

This Committee is obviously concerned with economies in housing. Whatever is done by Government to provide housing for the poor and low-income is going to cost money—a great deal of it. The obvious problem confronting all—is to use this money wisely and well. All of us who have worked in this field, particularly away from the central office, have seen waste. One area of waste that I have long deplored is that in Public Housing. It is difficult to understand the placement of a high-rise building in a small community—and there are many such—that house one-bedroom and efficiency apartments for the elderly. It can be five to twelve stories high. It is the only high rise-building in the entire small community. Land in these communities is quite cheap. It is common knowledge in the construction industry that once you go above the third floor, you go to a

heavier type of construction, i.e., steel or reinforced concrete, and the cost per square foot increases by 50%. Why do the Public Housing people in HUD continue to encourage this type of construction for people who in all their lives never lived above the second floor? Without a doubt, for the same dollars, we could produce one-third again as many apartments. There may be justification for high-rise construction in large urban communities where land near necessary amenities is scarce and expensive, but certainly not in cities with populations of 200, 5,000, or even 10,000.

The other area of concern is sale housing for the poor. It has been quite popular in recent years to encourage the poor to purchase their homes. In Milwaukee, we have housed over 1,000 welfare mothers in homes of their own. In addition, thousands of poor families are buying good, rehabilitated homes with the male head—a wage earner—obtaining either a subsidy under 235, or none because of his earnings. These programs have been pursued in other communities and HUD is increasingly striving to deliver the best possible rehabilitated home to these low-moderate income buyers. Predictably, this program too will fail, because no provision is being made for the dollars necessary to spend for significant major repairs and maintenance that will inevitably occur, no matter how well the older home is currently rehabilitated. The do-it-yourself skills are significantly absent among the poor and low-moderate income buyer in the central cities. Budget skills are also absent, and even if present, it becomes most difficult on meager earnings to put sufficient dollars aside to repaint the entire house when necessary—and it will be necessary within a few years; to make major carpenter repairs to front and rear porches—and that too will be necessary; a new roof, or a new furnace in due time. This kind of savings program involving hundreds of dollars is most difficult to launch and to maintain. The pressures for these dollars for immediate family needs will preclude this kind of saving program among many. The result is that today's well rehabilitated homes will come back to HUD in spite of all its precautions currently to do the best possible underwriting job. Unless we solve this problem which involves major counseling efforts and more, we will be confronted with acquisitions and massive financial losses far exceeding anything we have experienced up to now.

I am convinced that many of the low-income families currently buying homes in our central cities—if given the alternative—would prefer renting. Many are buying because they have no choice. There are no rental units available that will house a sizeable family. We desperately need more rental housing in the central cities, as well as scattered site housing for these families. The answer for these families is not cash allowances, for this would be another welfare approach—instead we need more and more new construction.

The subsidy housing programs we have experienced for over a decade have proven their worth—they do need revision and improvement and simplification. There is a need for some reduction in what I call "water" in the cost of replacement of FHA–HUD multifamily housing. There can be elimination of some fees and charges that serve only to inflate rents. The philosophy that encouraged and resulted in almost 100% financing for subsidized projects in the early 60's is not valid today. It is possible that it was not valid even then, but it was done. The limited distribution sponsor who obtains a 90% mortgage on cost of replacement—in reality does obtain 100% financing. As part of the cost of replacement, we include a builders and sponsors profit and risk allowance which amounts to 10% of the total cost of the project except for land. Using this for a credit against his 10% equity requirement, together with a 2% allowance as builders general overhead, not cost certifiable, he ends up with 100% financing. The same advantages and financing are available under Section 221(d)(4), an unsubsidized program.

These advantages in the early 60's were considered necessary to encourage builders to go into this program because of the assumption it was a high risk program. But was it? We have seen a tremendous amount of interest among builders to participate in these programs—not merely because of the ability to build without any investment, but to obtain an annual 6% return on the 10% equity position for the term of the mortgage—remarkable leverage. In addition to this, and of great incentive, are the tax advantages in the first year of construction and subsequent depreciation. A number of significant cost items, including interest paid during the construction period, taxes and fees, are deductible against personal ordinary income—cost items that come out of mortgage proceeds.

I would suggest that the incentive of tax savings be retained and this would prove to be of sufficient incentive for the continuation of builders and investors interest. On the other hand, I would encourage a cash investment by the sponsor by eliminating the builders and sponsors profit and risk allowance and substituting for it a builders profit similar to that allowable under Section 207. This would amount to approximately 5%. I would further encourage reduction of the mortgage insurance premium from ½ of 1% to ¼ of 1%, and a flat charge for processing an application, including inspection fee, to ½ of 1%. The FHA processing fee should not be included in the cost of replacement, 5% to 7% of the cost of replacement of an apartment house complex can be eliminated. This would result in lower apartment rents and less subsidy.

Of prime importance is the need for wise and skillful underwriting in the field offices. Where it exists, the defaults and losses will be within reason.

If there is thought of radically changing the current subsidy programs, certainly it should not be done without an enormous amount of trial experience. A change to something new without a significant analysis and trial will again result in abuses. The Nation can ill afford a huge outlay of subsidy dollars without adequate and sufficient satisfaction with the results achieved.

One last thought—in this past year HUD, through its project site selection criteria, is seriously discouraging the construction of subsidized housing in our inner cities. It is telling sponsors to seek sites elsewhere and to disperse subsidized housing. The concept is basically sound, but not if it means abandoning the central cities to the extent that it will see no new construction. The goal must be that the moderate-income and the poor living in the central city have a choice of housing, and if a choice does exist, i.e.—subsidized housing available on the perimeter of a city—HUD should permit construction in the central city for those who choose not to go to the perimeter of the city to live and would prefer remaining in the central city.

The central cities can and must be rebuilt. To merely talk about rehabilitation of 60 year old homes, with huge subsequent maintenance costs, is unwise if that is our only solution for the inner city. In every city there are areas where rehabilitation is no longer economically feasible. These areas are the haven of crime, degregation and despair. The only answer is clearance and with a reuse that stays away from high density reconstruction. Many of the larger urban cities are the victim of some peculiar philosophy which calls for high density, high-rise construction to replace what was originally medium and low density use. To many planners this seems to be the best use for land in the central city. Is it? In one breath these planners say that no one wants to live in the central city and therefore the land is not worth much. On the other hand, when substandard housing is destroyed for renewal, then the land suddenly becomes too valuable for replacement housing having the same density of the old. Much of this philosophy in the late 50's and early 60's stemmed out of racism that called for the containment of the expanding black population. I submit that this is not valid and that the reclaimed central city land can be used in most cities for medium and low density residential reuse.

This was done in Milwaukee 4 years ago. 9 square blocks of a larger urban renewal site was used for the construction of new single family homes. The old grid streets were eliminated. New streets, curvilinear with cul-de-sacs, were installed. New sidewalks, curb and underground wiring were installed. The pie-shaped lots similar to those in any suburban subdivision were used for the construction of a variety of single family homes—one-third subsidized and two-thirds conventionally financed. Anyone walking or driving through this subdivision within the central city would completely forget some of the blight still existing around it. The houses were not sold to those who had decided to return to the city from suburban living, but were sold to the people already residing in the neighborhood. These residents, practically all black, had a choice of buying a new home in suburbia, but chose their suburbia in the inner city. Why not more of this—in Detroit, Cleveland, Newark? Why do we have to replace our old substandard housing with high density construction that will end up being the tenements of tomorrow.

I thank you for the opportunity of appearing here and sharing these thoughts with you.

Chairman Proxmire. Thank you very much, Mr. Katz.

Mr. Smart, please proceed.

STATEMENT OF WALTER L. SMART, EXECUTIVE DIRECTOR, NATIONAL FEDERATION OF SETTLEMENTS AND NEIGHBORHOOD CENTERS

Mr. SMART. Mr. Chairman, my name is Walter Smart, executive director of the National Federation of Settlements and Neighborhood Centers. I will briefly discuss the subject of Federal housing subsidies from the following point of view:

Special problems of the minority poor population.

Some deficiencies in the housing subsidy program.

Some steps private groups have taken to bridge the gap and, lastly, some recommendations.

Statistics tell us that one out of every four American families move each year, basically because of changing job markets and new opportunities. What the statistics do not reveal, however, is that the residential instability in slum areas occurs because many families cannot secure shelter on any basis except a temporary one. The family pattern is for a minority female head of household, with four or more children, to accept any apartment which can be made available to her. Issues of size, cost, and condition are secondary considerations since she must find shelter for her family and she is painfully aware that the landlord of substandard housing is the only person who will allow her to rent an apartment. (The landlord is also aware of this fact and many of them have informed me that society should give them a medal for providing this service rather than constantly berating them.)

The female head of household has learned from many years of experience to respond to the question, "How many children do you have?" with the standard reply, "one or two." The landlord informs her that the rent, for the two-bedroom unheated apartment, is $95 per month. She pays the $95 and moves her family of four children into the two-bedroom apartment. The amount of rent she can afford to pay relative to the money she receives from public assistance is $80 per month, including heat. She was able to pay the full $95 initial rent, however, because she moved out of her previous apartment at night without paying the previous month's rent. However, when the next month's rent is due, she informs the landlord of some misfortune that has befallen her and she can pay him only $65 now but will pay the rest in 2 weeks. The landlord will, of course, hee and haw, but both she and the landlord know that he will accept the partial payment. At some point beyond the 4th month, the lady is so seriously delinquent in her rent that the landlord is threatening to have her evicted. She finds another apartment and moves under the cover of darkness and repeats the cycle again. I have personally known many families who have changed their names four and five times in order to get the electricity and other utilities turned on at the new apartment because by using their real name, they would have the impossible task of paying the entire former bill and placing a sizable amount of money on deposit against probable future delinquencies.

Then there are other problems of income which I have stated for the record. Discrimination continues to be a major problem. We find it to be pervasive in most communities around the United States.

It persists even though there are Federal and, in many cases, State laws prohibiting such discrimination. Generally, the mechanism for resolving the problem is so cumbersome and time-consuming that few families are willing to file complaints.

And I have listed several examples of that.

Third, there is a critical housing shortage for poor families. The Commission on Urban Problems and several other studies have documented the fact that the combined demolition of housing for highways and urban renewal has substantially reduced the supply of housing available to poor families and the situation is most acute for poor minority families.

Fourth, little or no protection under the law.

Most cities today have housing codes and violators of the code are liable under the criminal law. However, many cities, and, in my judgment, most cities, make little or no effort to enforce the housing code.

The Commission on Urban Problems visited approximately 22 cities and the responsible officials readily admitted that they had no intention of enforcing the code because of humane considerations. They felt that if the code was enforced, the slumlord would simply vacate and then abandon the building, thereby causing hundreds or perhaps thousands of families to be homeless.

In one city with which I am familiar, the responsible city agency is diligently trying to enforce the code. However, the court has the attitude that there are no slumlords; there are only slum families who wreck the owner's buildings. Therefore, slumlords brought before him are most frequently released with a sympathetic pat on the back.

In one instance, the city determined a building to be totally unsafe and thus uninhabitable. The city placed large signs on the building indicating it to be unlawful to rent the building. The slumlord not only rented the building, but used the back of the city's sign for a rent receipt. The judge did fine the slumlord, however, a total of $10.

Most minority poor families have learned that making a formal complaint to the authorities about housing deficiencies is a waste of time.

Now, with the existing housing programs, skipping public housing, FHA section 221(d)(3), I believe, was one of the better subsidy programs that we have had, which provided loans to developers below market interest rates, direct loans from the Government or guarantees.

I believe we achieved better racial and economic integration in that housing program than in any of the other programs today.

Major problems arose with the program, however, after a HUD official established a regulation limiting the amount of write-down a local authority could make on land to be used for such purposes. Prior to this regulation, most land for 221(d)(3) development (at least in Boston) was sold at approximately 10 cents a foot. The new regulation required that the land be sold at no less than $500 per unit. Thus, this substantially increased the cost and the resulting rent structure required to meet such costs.

In many renewal areas, there is land that private developers overlook because of severe subsurface conditions. Local redevelopment authorities, of course, incorporate such land because of the scarcity of land

area for the development of housing. At one point HUD would allow subsurface improvement, such as footings and some pilings to be handled as an eligible project cost. More recently, HUD has refused to recognize such costs, and this cost then is passed on to the developer and ultimately to the low-income tenant.

FHA section 221(d)(3) market interest rate with rent supplement.

By building housing at market interest rates, the rent structure is, of course, quite high. When such a development is located in a slum or ghetto, such developments cannot be rented unless they receive supplements for 100 percent of the units. Thus, the unit is another form of public housing and frequently with less amenities.

HUD regulations are much too severe. Under the program, children under 6 are assigned to the mother's bedroom.

FHA section 236, in my opinion, is the most expensive form to provide housing subsidies to families needing such assistance. This, of course, has been documented by various studies and I will not dwell on the point.

It has been my experience that when plans for new developments are presented and are costed out, they invariably come in over the per unit cost. The architects are instructed to redesign and come in with a cheaper unit. This process seldom takes less than 6 months and frequently longer. At this point in time, such costs were increasing in the city of Boston 1 to 2 percent per month. Therefore, the 6 months' or 8 months' time required to redesign causes an additional 6 to 10 percent increase in the construction costs. There were many units that had to be redesigned and I believe that we simply got a cheaper unit at a higher cost by this kind of delay because of the lack of some ability to waive that per unit cost at an appropriate time, all facts being considered.

FHA 235, I think, is an excellent program, at least for existing housing where the subsidy goes to the homeowner seeking to purchase a home. The major problem is, of course, the lack of counseling for families who have not had any home owning experience in the past. I have documented here several case histories for the record where homeownership can and does work for low income families, including families receiving welfare assistance.

With one program with which I was associated for more than 4 years, we helped over 300 families even without assistance because, in Boston, banks would not handle the 235. None of these families are in default. They are all doing very well.

Let me skip then—Let me say one thing about rehabilitation because I believe that massive rehabilitation as it has presently occurred will will have as negative an impact on a community as 235 has had on the community in Detroit.

This program, and again the key thing here, I think, is the lack of control, the lack of accountability. From the assembly of the properties to be rehabilitated, I think it is wide open for speculation. As you have heard testimony this morning, I have known of cases where properties which were selling at 1½ times income were assembled for this purpose at 4 times income and all of this cost, of course, passed on to the poor. But the key thing is the manner in which these programs are thrust on the community without any warning, without

any kind of preparation. And substantial numbers of families are displaced in the most inhumane way imaginable.

In one case that I was familiar with, the developer would give the tenant a 30-day vacate notice at the time the tenant paid his rent. Thus, if the tenant paid his rent on the 12th of the month he would get his notice date the first of that same month. The notice would state that all utility companies had been advised to shut off the service at the end of the month. This was in January and February and hundreds of families were apparently without heat or light as a result of this program to improve the community.

Now, jumping to recommendations. I think we must recognize that families whose earnings are at a minimum wage level or whose incomes through public assistance is set by Federal and State law cannot bear the cost of inflation. Establishing a level of subsidy makes little sense unless it is sufficient to get the job done.

To allow existing public housing units, for example, to deteriorate as is currently happening causes a far greater loss of public resources, both human and financial, than would be the cost. Few of us will see the day when we will have full employment and wages sufficient to meet prevailing cost of living.

Our Government has not attempted to deal with rising cost in a serious manner, but there is continuing discussion about producing cheaper housing for poor and moderate income families. However, without controlling some or all of the costs involved, the cheaper housing we produce will be inferior housing and probably will deteriorate more rapidly than amortization will.

I, therefore, strongly urge the Congress of the United States to seriously consider establishing a public works administration to undertake the construction of public housing and the necessary supporting facilities, and I think through this approach costs can be controlled.

With most of the other programs my recommendations deal with control and accountability, and I think that can be achieved through greater encouragment of local development corporations to become involved and through making the developer subservient to these community needs.

I have listed examples here of a rehabilitation program in the city of Boston dealing with the same kind of families as were in project rehab; average income $3,200, there are no delinquencies, the rent is 100 percent paid, the families have been there 4 years, it is not vandalized. It is good housing. The difference is in management accountability and control.

Chairman Proxmire. Thank you very, very much, Mr. Smart, and your entire prepared statement will be printed in full in the record.

(The prepared statement of Mr. Smart follows:)

Prepared Statement of Walter L. Smart

My name is Walter L. Smart, Executive Director of the National Federation of Settlements and Neighborhood Centers. NFS has 200 member agencies which operate 419 centers in 80 cities and 30 states. Seventeen metropolitan or regional federations of neighborhood centers also are affiliated with the National Federation.

Prior to joining the staff of the National Federation, I was with the Boston Redevelopment Authority for 10 years, in a number of positions such as Project Director, Director of the Department of Family Relocation, and Administrator

of Community Organization and Social Services. Between 1966 and 1968, I served on the staff of the President's Commission on Urban Problems, chaired by former Senator Paul Douglas and directed by Howard Shuman.

I will discuss the subject of Federal Housing Subsidies from the following points of view:

A. Special Problems of the Minority Population
B. Deficiencies of the Housing Subsidy Program
C. Some Steps Taken by Private Groups to Bridge the Gap
D. Recommendations to Make Housing Subsidy Programs More Effective and Viable

I also will discuss the impact of the existing housing subsidy programs on economic and racial integration.

A. SPECIAL PROBLEMS OF THE MINORITY POPULATION

I have been concerned about housing problems throughout my professional career beginning in settlements in Philadelphia, Pa. in 1956.

I fully realize that providing all Americans with decent, safe and sanitary housing at prices they can afford to pay will not solve all of our urban problems. On the other hand, however, I believe that the solution to other chronic social ills will continue to elude us so long as families are unable to find adequate shelter. Thus, I appreciate this opportunity of sharing some of these concerns with you.

Statistics tell us that one out of four American families move each year, basically because of changing job markets and new opportunities. What the statistics don't reveal, however, is that the residential instability in slum areas occurs because many families cannot secure shelter on any basis except a temporary one. The familiar pattern is for a minority female head of household, with four or more children, to accept any apartment which can be made available to her. Issues of size, cost, and condition are secondary considerations since she must find shelter for her family and she is painfully aware that the landlord of substandard housing is the only persons who will allow her to rent an apartment. (The landlord is also aware of this fact and many of them have informed me that society should give them a medal for providing this service rather than constantly berating them.)

The female head of household has learned from many years of experience to respond to the question, "How many children do you have?" with the standard reply, "One or two." The landlord informs her that the rent, for the two bedroom unheated apartment, is $95.00 per month. She pays the $95.00 and moves her family of four children into the two bedroom apartment. The amount of rent she can afford to pay relative to the money she receives from public assistance is $80.00 per month, including heat. She was able to pay the full $95.00 initial rent, however, because she moved out of her previous apartment at night without paying the previous month's rent. However, when the next month's rent is due, she informs the landlord of some misfortune that has befallen her and she can pay him only $65.00 now but will pay the rest in two weeks. The landlord will, of course, hee and haw, but both she and the landlord know that he will accept the partial payment. At some point beyond the fourth month, the lady is so seriously delinquent in her rent that the landlord is threatening to have the constable evict her and her children. She finds another apartment and moves under the cover of darkness and repeats the cycle again. I have personally known many families who have changed their names four and five times in order to get the electricity and other utilities turned on at the new apartment because by using their real name, they would have the impossible task of paying the entire former bill and placing a sizeable amount of money on deposit against probable future delinquencies.

In such communities the pupil population within the local school district changes each year by 50–60%. Thus, special efforts in such schools to improve reading skills, etc. have no sustained impact on the population the program was designed to reach.

There are definite patterns of behavior that people will acquire in attempting to survive in slums. Such patterns are not easily discarded when and if better housing in a new environment is made available. Skilled counseling and other supportive services can, in most instances, assist families in making the appropriate adjustment to radically changed conditions, rules, and regulations.

1. *Income*

In the United States during 1971:

Average median income for Negro families	$6,279
Average median income for white families	10,236

Source: U.S. Department of Labor, Bureau of Labor Statistics, Office of Regional Director, NYC.

Total number of American families below poverty income level	5,303,000
Of that number:	
Whites below poverty level	3,751,000
Negroes below poverty level	1,484,000
Other—constitutes the difference in the above figures	
Percent of whites below poverty level	7.9
Percent of Negroes below poverty level	28.8
Poverty level for all families	$3,700

Source: Current Population Reports—Bulletin P–60 No. 82—1971, U.S. Department of Commerce.

The practice of red-lining huge geographical sections of a city by the Banking and Insurance Industry makes mortgage financing impossible within those areas, except through exorbitant interest rates.

2. *Discrimination*

Discrimination by rental agents or sale agents is a major problem for minority groups in securing decent, safe and sanitary housing. Within many cities, for example, it is almost impossible to check the availability of a rental unit, or sales unit, over the phone. Agents insist on an office visit, presumably to be able to determine the race of the applicant. During my many years of relocating families, we discovered that agents maintained or kept listings of decent housing under the counter and maintained a listing of a few substandard derelict properties on the counter, so that if the wrong client entered, he would be shown units from the available list on the counter. Refusing those, he would be advised to check back in a few days to determine if anything else had come on the market.

Problems of discrimination persist, even though there are federal, and in many cases, state laws prohibiting such discrimination. Generally, the mechanism for resolving the problem is so cumbersome and time consuming that few families are willing to file complaints.

In most instances, if the family requires housing within a relatively short period of time, it is almost a certainty that they would not secure the unit for which they entered a complaint—again, because of the time involved. Example: A Black family moved to a suburban area seeking rental housing for a period one year. The head of the household was employed by the State Department, and was there to take special courses at Boston University. He was discriminated against by one of the leading realtors in this suburban community. The Fair Housing Committee filed a complaint with the State Civil Rights Commission. The case was then turned over to one of the Commissioners for investigation. The Commissioner met with the realtor, who informed him that he couldn't afford to rent the unit to this family because he had too much money invested in that area. The Commission did not issue an injunction preventing the rental of the unit until the matter was resolved, but stated that it would hold hearings on the matter. Each week, someone from the Civil Rights Committee would call to determine when the hearings would be held, and they would be informed "as soon as possible." Meanwhile, under the law, if the realtor rented the unit to another family, the case would be closed.

In this instance, part of the membership of the Committee joined with the local chapter of CORE and led a peaceful demonstration in the center of town with placards naming the person who was discriminating against the family. As a result of this demonstration, the owner relented and rented the apartment to the family seeking the housing. In most instances, however, such committees are not available to work on behalf of families being discriminated against; and, secondly, many such cases of discrimination would not be resolved through such demonstrations. Thus, most must rely on the cumbersome, long drawn-out process of filing a complaint and hoping for the best.

Another aspect of this problem is discrimination against welfare recipients and families with children. Relocation staff are frequently informed that units

containing two and three bedrooms are not available for families with children. The agents indicate that the owner has stipulated these conditions. Residents of another suburban community inform me that the town will not grant a zoning variance for apartment buildings, if the developer plans to accept families with children. Ostensibly because of the impact such families would have on local schools.

3. *Critical housing shortage*

The Commission on Urban Problems and several other studies have documented the fact that the combined demolition of housing for highways and urban renewal has substantially reduced the supply of housing available to poor families and the situation is most acute for poor minority families.

4. *Little or no protection under the law*

Most cities today have housing codes and violators of the code could be prosecuted as criminals. However, many cities, and my judgment would be most cities, make little or no effort to enforce the housing code.

The Commission on Urban Problems visited approximately twenty-two cities and the responsible officials readily admitted that they had no intention of enforcing the Code because of humane considerations. They felt that if the Code was enforced, the slumlord would simply vacate and then abandon the building, thereby causing hundreds or perhaps thousands of families to be homeless.

In one city with which I am familiar, the responsible city agency is diligently trying to enforce the Code. However, the Court has the attitude that there are no slumlords; there are only slum families who wreck the owner's buildings. Therefore, slumlords brought before him are most frequently released with a sympathetic pat on the back.

In one instance, the City determined a building to be totally unsafe and thus uninhabitable. The City placed large signs on the building indicating it to be unlawful to rent the building. The slumlord not only rented the building, but used the back of the City's sign for a rent receipt. The judge did fine the slumlord, however, a total of $10.00.

Most minority poor families have learned that making a formal complaint to the authorities about housing deficiencies is a waste of time.

B. DEFICIENCIES OF THE HOUSING SUBSIDY PROGRAMS

Under this heading I will discuss public housing, including leased housing, FHA–221(d)3 Below Market, 221(d)3 Market Interest with Rent Supplement, 236, 235, Section 312 and Section 115.

1. *Public housing*

a. *Location.*—It probably is common knowledge that while many people in a city will agree on the need for public housing, few, if any will agree that such housing should be built in their community. Thus, those responsible for the developing of public housing within cities have, in large part, chosen locations that were ill-suited for housing low income families. Too, because of the scarcity of locations, they built at very high density level.

b. *Design.*—With the exception of housing for the elderly, most public housing for families appears to be designed in a way to make families ashamed to live there—perhaps because of a belief that people living in public housing should be encouraged to move out as rapidly as possible, without realizing that such design has a blighting influence on the neighborhood and broader community.

It also appears that little consideration was given to the life-style of people in terms of the interior design. A large high-rise with long corridors built-in problems of maintenance and upkeep.

c. *Security.*—In many large cities there is a problem of providing adequate security for residents in private as well as public housing. Many tenants of public housing feel that the problem is worse than need be in their developments.

d. *Tenant Selection.*—Until recent times, this process functioned to deliberately segregate families applying for public housing. Thus, in practically every city in America, there are all-white or all-black projects, not always at the request of the tenants, but by the determined efforts of those who were involved in the selection. This problem of discrimination in public housing is exacerbated for minority families because of an apparent assumption that within non-white families, there are no standards for a tenant's behavior. Thus, the opportunity for "strong families" with high behaviorial standards obtaining a unit in a

well-managed, well-run development has been extremely slim, if not entirely impossible. In my experience, many such families who were desperate for housing had no alternative but to refuse public housing rather than be assigned a unit in a development where the environment, physically and socially, was so poor.

e. *Size of Units.*—Few public housing developments build units for large families. Thus, families requiring five and six bedrooms and who, in my opinion, have housing problems more severe than others, often find this problem impossible to solve because of the refusal of responsible officials to build such units in sufficient numbers in public housing.

2. *FHA—Section 221(d)3 below market interest rate insured housing*

This was one of the better housing subsidy programs through which the developer received a loan at approximately 3% versus the going market rate of interest. It was in such housing that I believe we achieved better economic integration than in any of the other subsidy programs that will be discussed later.

Problems arose with this program, however, after a HUD official established a regulation limiting the amount of write-down a local authority could make on land to be used for such purposes. Prior to this regulation, most land for 221(d)3 development (at least in Boston) was sold at approximately 10¢ a foot. The new regulation required that the land be sold at not less than $500 per unit. Thus, this substantially increased the cost and the resulting rent structure required to meet such costs. In many renewal areas, there is land that private developers overlook because of severe sub-surface conditions. Local redevelopment authorities, of course, incorporate such land because of the scarcity of land area for the development of housing. At one point HUD would allow sub-surface improvement, such as footings and some pilings to be handled as an eligible project cost. More recently, HUD has refused to recognize such costs, and this cost then is passed on the developer and ultimately to the low-income tenant.

3. *FHA—Section 221(d)3 market interest rate with rent supplement*

By building housing at market interest rates, the rent structure is, of course, quite high. When such a development is located in a slum or ghetto, such developments cannot be rented unless they receive supplements for 100% of the units. Thus, the unit is another form of public housing and frequently with less amenities.

HUD regulations are much too severe. Under the program, children under six are assigned to the mother's bedroom, whereas in other housing programs, a separate bedroom would be permissible.

4. *FHA—Section 236*

In my opinion, this is the most expensive form to provide housing subsidies to families needing such assistance. This, of course, has been documented in the study by Henry Aaron and Dr. Henry Schecter; thus, I won't dwell on that issue except to say that the resulting rental in a 236 development, even with the subsidy on the interest rate, comes out so high that few families in an urban renewal area, model cities area or NDP area can afford such housing. Thus, I believe there will be growing community resistance to such housing when offered as part of a program to improve the community for the residents of that community. For example, 4-bedroom units in Boston under the 236 program are averaging $205 per month. This would require an income of $12,300. For each of these subsidy programs involving new construction, HUD has a ceiling on the per unit cost. I am not opposed to a ceiling, but such a ceiling should be realistically set. By setting the ceiling below actual cost, the program winds up being penny-wise and pound-foolish.

It has been my experience that when the plans for new developments are presented and are costed out, they invariably come in over the per unit cost. The architects are instructed to redesign and come in with a cheaper unit. This process seldom takes less than six months and frequently longer. At this point in time, such costs were increasing in the City of Boston 1 to 2% per month. Therefore, the six months' or eight months' time required to redesign causes an additional six to ten percent increase in the construction costs. There were many units that had to be redesigned for a second time, until the cost met the limit of FHA. In some of these instances, the increased cost was not that substantial; therefore, I believe a judgment has to be make as to whether you lose more funds by building in an inflationary cost and getting an inferior unit, or by deciding to raise the per unit cost limit when it is prudent to do so with all facts considered.

5. *FHA—Section 235*

The design of this program, I believe, is excellent. All of the problems with it are administrative. The major problem is that practically no one knows about the program. In gatherings of sophisticated people who are not related to the housing field, few, if any, know about Section 235. Thus, the target population we are trying to reach with the program knows even less. Knowledge of the availability of the program and of the facts regarding the program, I believe, is an essential first step. Secondly, it is a program in which counseling is essential. Without such counseling under the right auspices, the problems that developed around Section 235, it seems to me, were clearly predictable. Such counseling in my opinion must be provided by private, non-profit agencies in the community, the cost of which should not be attached to the mortgage to be borne by the low-income family; nor, in my opinion, should it be paid for by the banks making the loan. Such service should be separate and independent.

There is an inexcusable delay in the processing of any new developments by HUD. I am attaching as an exhibit the chronology of one effort in St. Louis, Missouri to develop a 221(d)3 housing development with rent supplement as an example of unimaginable delays. Such delays increase administrative costs fantastically, not only to the sponsors of the development, but to the developers as well.

6. *Section 312*

This is another excellent program for which there are not sufficient guidelines and controls. In one urban renewal area with which I am familiar, the primary recipient of subsidies to this program were people earning $20,000 or more, with families needing such assistance not receiving the appropriate help.

7. *Section 115*

This program began with $1,500 grants to those homeowners who lacked the resources to improve housing deficiencies and thus meet the rehabitation standards required in urban renewal or code enforcement areas. Today the amount of the grant allows $3,500. Yet, if a house is seriously deteriorated, one cannot remove all violations with $3,500, again making total repairs impossible. In renewal areas, HUD has permitted the hiring of local youth during the summer months to achieve certain economic and social objectives. However, HUD restricts the manner in which youth can be employed. We were restricted from using such youth on private property. However, by securing funds from another source, I found that using such youths with adequate supervision was the best way to help poverty-level howeowners rehabilitate their homes. In those instances, the 115 grant was used to make repairs beyond the competency of the youth crews such as roofing, plumbing, electrical work. The crews did become involved in exterior and interior painting, the laying of floor tile, pointing of brickwork, that produced a unit that was an asset to the community, one which it was a pleasant experience to live in and to live next door to.

8. *Rehabilitation—Under section 236*

In one city, to my knowledge, the impact on the community of massive rehabilitation efforts under "Project Rehab" will be as negative as Section 235 has been on Detroit. The major problems appear in both the design and administration of the program.

a. *Program Design.*—(1) The program seeks housing units which are occupied and require the least amount of work, thereby leaving the community with the continuing problems caused by vacant buildings.

(2) The program causes substantial displacement of families in the most inhumane manner imaginable, if it occurs outside of an urban renewal, model cities, NDP or code enforcement area. There are no funds to provide relocation payments or services.

Example: I was informed by one local FHA Director that the developers assured him that they were handling the relocation problem. I discovered that their method was as follows: Tenants would be given a thirty (30) day vacate notice at the time they paid their rent for the month. Thus, if tenant "A" paid his rent on the 12th of the month, he would receive his vacate notice dated on the 1st of the same month, providing him with only 18 days to vacate his apartment. The notice would state that the utility companies already have been notified to shut off all services on the 30th of the month. A substantial number of families

found themselves in a dark building with no water, heat or electricity during the months of January and February.

(3) There is a serious lack of accountability on the part of developers. The Joint Center for Urban Studies at MIT and Harvard did a study documenting the shabby work related to one massive rehabilitation program. I realize that inspection procedures are part of an administrative problem, but I don't believe that by improving the inspection procedures we will solve the problem. In dealing with a "captive" population, one so desperate for housing that they must accept anything that is provided, the tendency of the developer will be to maximize profits and minimize time and effort. Thus, I believe that developers in these instances must be made subservient to local community development corporations.

The process of assembling properties for the rehabilitation package is wide open to speculation and can divert all of the advantages of the program away from the intended beneficiaries to unscrupulous developers.

Example: In one such effort, the developers were told that there was a per unit cost of $14,000 for purchase and rehabilitation with no dollar limit on either purchase of rehabilitation so long as both costs did not exceed $14,000. Property was assembled in an area where the going rate was 1½ times income, yet some of the developers paid four times income. This practice caused rents to be substantially higher than they might have been.

The lack of suitable controls and appropriate levels of accountability can, and frequently does lead to serious management problems when units are occupied.

Such programs are thrust upon communities without warning, causing substantial family displacement, providing shoddy workmanship, and generally raising rent levels on apartments, some of which met the local housing code before being included in the rehab package.

The program is not designed to improve community conditions.

C. SOME STEPS TAKEN BY PRIVATE GROUPS TO BRIDGE THE GAP

1. *Advocate counseling*

Fair Housing, Inc. This agency, located in Boston, Massachusetts, began its activities as an organization to assist minority families in securing housing outside of the ghetto and particularly in the metropolitan area surrounding Boston. Their efforts were fairly successful in terms of those families seeking such assistance. However, families moving to the suburban communities required an income of $10,000 plus. Thus, there weren't many applicants. Meanwhile, many families were seeking assistance for housing problems.

The program was expanded to provide assistance to families seeking an end to the continuous cycle of temporary housing, and to find a more permanent solution to their housing problems. A good indication of the overwhelming need for such services is that the office quickly became so swamped with requests for help that the office closed for two months to catch up with the backlog.

Fair Housing, Inc. discovered that it was impossible to find standard rental units for most of the families, but standard sales units could be secured if the the obstacle of a down payment could be overcome.

Fair Housing, Inc. secured funds from foundations and other philanthropic sources to loan the necessary funds to families for the down payment. Then, through skillful counseling and technical assistance, Fair Housing, Inc. assisted more than 300 families to obtain sales housing. A significant number of these families were receiving partial or full public assistance. I was closely involved with the program over a period of four years and not one default was reported during that time.

The following are a few cases histories to illustrate the effectiveness of this approaches:

Mrs. O.—Mrs. O is a divorced woman, mother of five children. She has an income of $7,000 per year from AFDC and a part-time job at a day care center. The family was under an eviction notice after filing a complaint with the Code Enforcement Agency for insufficient heat and other substandard conditions. The rent on her apartment was $130 per month. Through the assistance of Fair Housing, Inc., the family purchased a two-family home in the Mattapan Area of Boston for $13,000. $1500 for roof repairs were written in the mortgage. The carrying charge for the family was $153.20 per month. The closing cost (the down payment of $509) was loaned to the family by Fair Housing, Inc. After repaying the loan to Fair Housing, Inc., Mrs. O decided to convert her 2-family home into a single family home and to take in foster care children. Mrs. O has a

double A rating from the Division of Child Guardianship in Massachusetts and is providing excellent service to the community in addition to providing adequate housing for her own family.

Mr. and Mrs. P.—Mr. P. is employed, earning an income of $6,300 per year. The couple have five children and lived in public housing. The family first sought to purchase a home through a bank within Boston, but was refused because they wanted to move outside of the area which the bank required purchasers to move to in order to receive a loan. Through the assistance of Fair Housing, Inc. the family purchased a single-family home in Hull, a suburban community, for $14,500. The down payment was $2,500; carrying charges were $169 per month. Fair Housing, Inc. loaned the family $1,000 toward the down payment. This loan has been repaid. Mr. P. has taken a second job in a gas station to provide the family with additional income it requires.

Mrs. J.—Mrs. J. is a widow with eight children. Her income, $5,638 per year, all of it being derived from AFDC. The family lived in a dilapidated 5-room apartment at $80 per month. There was an unfortunate fire and the family was completely burned out. There was no public housing available for this size family. Thus, the family moved in with the grandmother temporarily, and applied to Fair Housing, Inc. for assistance. Fair Housing, Inc. helped the family to purchase a 2-family home for $14,000. Fair Housing, Inc. loaned this family $500, which has since been repaid, for a down payment closing cost. The monthly carrying charges on the property are $175 per month. The family receives $105 for the rental unit; thus their monthly cost is $70 per month.

Mr. and Mrs. S.—Mr. and Mrs. S. have five children and a total income of $7,512. This income is derived from AFDC disability and Commonwealth Service Corps aid. The family was living in grossly substandard rental housing, with a deep desire to move out of the slum area. Mr. S. is an amputee and they have two children that are handicapped. Fair Housing, Inc. with their contacts with suburban housing committees, discovered that there was a 235 housing development in Brockton, Massachusetts. There was no advertising in the Black community within Boston relative to the availability of housing under this program. Fair Housing, Inc. workers spent a considerable amount of time and effort in helping the family to purchase a home in Brockton under the 235 program. Carrying charges for the family—$155 per month. Without the help of Fair Housing, Inc., the family never would have known they were eligible for 235 housing, or how to go about finding such housing. The FHA program used for most of these purchases, however, was 221(d)2.

For several years, none of the banks in Boston nor the insurance companies would handle a 235–I mortgage, claiming there was too much paper work involved in determining family income and eligibility for the program.

The second point I wish to make is that there was one insurance company that provide loans through FHA 221(d)2. The regular Boston banks would not grant such mortgages unless families agreed to move in a certain prescribed area they had delineated for Black families. The main point here is that far from having an open market and free access to mortgage assistance, most families will continue to find their housing problems impossible to solve without an agency like Fair Housing, Inc. available to provide such assistance.

South End Development Corporation.—The United South End Settlements of Boston undertook a rehabilitation experimental program. The settlement was able to put up $75,000 and secured $125,000 from a local foundation, then received an extra $250,000 from HUD under the 207 demonstration program. The settlement then hired an extremely capable person, by the name of Bob Whittlesey, to administrate the program. The South End Community Development Corporation rehabilitated 100 units of housing in the South End of Boston. In all of my travels, I believe from what I have been able to see, it appears that the quality of rehabilitation in the South End is superior to any other I have seen to date.

There are some other outstanding characteristics of this program:

(1) The average family income for the tenants is $3200 per year.
(2) 75% of the units are leased to the housing authority.
(3) They have a stable tenancy.
(4) Rent collection is good.
(5) The units are not being vandalized by the tenants.

This, I believe is a remarkable example of how HUD subsidy programs can be utilized versus the results we generally get in high vacancy rates, developments moving in default, serious rent delinquency problems.

The outstanding factors that made the difference, I believe, were:

(1) Capable, knowledgeable administrator.

(2) Builders being involved were working for the South End Community Development, Inc. They were supervised and had to perform for this corporation as they would have to perform for any other. In other words, the accountability factor was tied down.

(3) There were tenants and other homeowners of the South End participating on the board of the South End Community Development Corporation. The basic motive of this group was not to maximize profits, but to improve neighborhood conditions and to provide housing for families of low income. Thus, there is a very good rapport between tenants and management.

Tenant Controlled Corporations.—Also in Boston there are 2 tenant-controlled corporations. One is basically Puerto Rican and the other Black. Both have assumed responsibility for rehabilitation and management.

The South End Urban Renewal Area boasts that it is perhaps the most heterogeneous community within the City of Boston, with more than 25 different nationalities or ethnic groups residing within the South End. Because of the proximity to downtown and some exciting architecture within the community, there is also good economic integration in the community. However, the pressure of the real estate market was such that low income families were being threatened to be pushed out of the South End entirely because of the large number of middle income families moving into the community, buying existing housing and converting two or three family homes to one family homes. Through the efforts of the United South End Settlements and the South End Community Development Corporation, members of the staff of the Boston Redevelopment Authority, two tenant organizations were helped to purchase some existing housing for rehabilitation. Both efforts have been remarkably successful, the key being, again, the availability of competent technical assistance being made available to the corporations. Many meetings were spent with the leadership of the tenant corporations in order that they might express their desires on the extent of rehabilitation desired, the builders to be hired to do the job, and on all issues regarding the rehabilitation of the units. This process has resulted in the development of fierce pride in the units being rehabilitated and in the role which their corporations are playing.

Another Example of Steps Taken by Private Groups.—In St. Louis, Missouri, a settlement known as the United Church of Christ Neighborhood Houses is located across the street from a large public housing development. This development consists of 4 high-rise structures. The conditions of the public housing units are deplorable. There is a play area covered by concrete with broken glass covering the entire area, trash strewn all over the lawn area, with the exception of one building. In this building, the settlement started a partnership program with the tenants in an effort to improve the quality of their living quarters and of their social environment, as well. Under this program the settlement secured funds from local church groups in St. Louis to purchase paint; then with the agreement of the housing authority, the tenants were assisted to paint not only the interior of the apartments, but the hallways as well. The tenants chose, bright, cheerful colors for this purpose. The settlement also provided a salary supplement for the housing authority's maintenance personnel to permit one maintenance person to be assigned to this high-rise building full time. This maintenance person, commonly called the building manager, also lived within that building. The grounds surrounding that building were kept in first class condition by this maintenance person. The building was completely secure.

Prior to the beginning of this program the tenants related how youths from other areas would snatch pocketbooks and run into the development for refuge and that the laundry facility on the first floor was always broken and women were afraid to enter for fear of being attacked by some outside person. On the day of my visit to the development, the laundry was working perfectly (I understand it is never broken now); women were walking through the halls without fear and the tenants' association, with the assistance of the settlement group, are utilizing first floor apartments under agreement with the housing authority for tutorial programs and other programs for younger children within the development. I was informed by the tenants that there is no turn over in the building; there is no rent delinquency in the building; and the tenants are happy with their housing.

D. RECOMMENDATIONS TO MAKE HOUSING SUBSIDY PROGRAMS MORE EFFECTIVE

General

We must recognize that families whose earnings are at the minimum wage level, or whose income, through public assistance, is set by state or federal laws, cannot bear the cost of inflation. Establishing a level of subsidy makes little sense unless it is sufficient to get the job done and the level raises proportionately with increased cost.

To allow existing public housing units to deteriorate as is currently happening causes a far greater loss of public resources, both human and financial, than would be the cost to permit suitable improvements.

While all of us would like to see the day when we will have full employment at wages sufficient to meet the prevailing cost of living, I don't believe we will achieve that goal without our lifetime, or perhaps the next. The gap between what poor and moderate income families can afford and the prevailing cost of living is becoming wider. Our government has not attempted to deal with rising cost in a serious manner, but there is continuing discussion about producing cheaper housing for poor and moderate income families. However, without controlling some or all of the costs involved, the cheaper housing we produce will be inferior housing and probably will deteriorate more rapidly than amortization.

I am primarily concerned with our troubled cities. The paradox is that while there is a colossal need for new construction and rehabilitation activity, there are rising levels of unemployment and limited opportunity of finding employment that will produce sufficient income relative to the cost of living.

The problem for minority groups is most acute. I don't believe that anyone would take a position that we have been successful in helping minority groups gain free access to the building and trade unions, and if the current pace continues, it would appear that they never will.

I, therefore, strongly urge the Congress of the United States to seriously consider establishing a Public Works Administration to undertake the construction of public housing and the necessary supporting facilities, i.e. parks and playgrounds. In this way, I believe the government can effectively control costs at a reasonable level and, at the same time, provide broad employment opportunity to the unemployed in our troubled cities. Such housing, if carefully planned and well designed, will be an asset to our society as a whole.

Since the middle 30's, we have had positive proof that our free enterprise system cannot provide adequate housing for low and moderate income families. Various gimmicks to make it work have not been successful in producing the quantity or the quality of housing that is needed. However, the cost involved has been far in excess of what it should have been. I am a strong supporter of the free enterprise system in those areas where it can and does function effectively.

The present policies of HUD will never lead to economic and racial integration. The site selection policy is to exclude those areas of heavy minority concentration. Yet no family, including Black families, desire to live in bombed out communities with dilapidated housing. We must rebuild the inner city. Obviously, this requires a large scale undertaking to make certain that negative environmental factors are appropriately handled. Such efforts could ultimately lead to a more open and more free real estate market.

Specific recommendations

I. *Make provision for skilled counseling under appropriate auspices.*—The ultimate aim of such service is to help the family to become independent of such outside assistance. Therefore, the following characteristics should be included:

A. Informational. The service must be knowledgeable of all housing assistance programs and make such information available to the client in order that real choices are presented.

B. Independence. The counseling service should be provided by a private non-profit organization.

C. Advocacy. The agency must be willing to work for the client and not be controlled by other interests.

D. Flexible. The objective of the counseling service should be to assist the family in solving their housing problem. This will require imagination and a willingness to try various approaches.

II. *Provide Greater Opportunity For Indigenous Groups To Own the Land.*—

A. Provide financial assistance to private non-profit agencies for the provision

of expert technical assistance to local community development corporations. This service should be established on a regional basis.

B. Make federally insured loans and subsidies for rehabilitation available *only* to local development corporations, if the rehabilitation program is to occur within a ghetto or barrio.

C. Develop criteria for legitimate local development corporations versus a group pulled together by a speculator as a front organization. Such criteria, in my opinion, should not include a requirement for public election to office.

III. *Create a Federal Trust Fund for Low and Moderate Income Housing Similar to the Highway Trust Fund.*—Millions of dollars could be saved simply by providing direct government loans to qualified Housing Development Corporations versus the current practice of subsidizing the interest rates. If such loans were made available at 2% interest, the fund would grow as well as pay for its own administrative cost.

Equally important, such a fund could provide individual mortgages through a local correspondent if local banks refused to accept 221(d)2 mortgages .

As I pointed out earlier, no bank or insurance company in Boston would accept a 235 mortgage and only one insurance company would accept a 221(d)2 mortgage.

Today, the situation has slightly changed, but the hundreds of minority families who were being displaced and were seeking such mortgages will not benefit.

ATTACHMENT 1

MURPHY-BLAIR SOUTH—THE STRUGGLE TO SURVIVE

If housing for low and middle income families can't be built here and succeed, it can't be built anywhere. This statement made by Mr. Gordon Herzog of the Grace Hill Settlement House Board of Directors.

Mr. Herzog was referring to the Murphy-Blair District in St. Louis which Grace Hill, a United Fund Agency, has served for nearly 70 years. Grace Hill House, residents, and businessmen in the district have developed a comprehensive plan for rebuilding and stabilizing the community. The strengths and assets are:

Involvement of civic and business leaders in the St. Louis Metropolitan Area.

Close cooperation with local businessmen. (The 14th Street Businessmen's Organization, along with residents, has developed a plan for a mall to be built with the area. Construction should begin soon. The Businessmen's Organization has doubled it's membership within the last year, and is making long range plans for improving the business district along with housing planned.)

Grace Hill Settlement House is certified by the Department of Housing and Urban Development as a counseling agency, provides social services, day care, health care, employment, mental health, home management and credit counseling among its many services to the community.

The Property Management Division of the agency which presently manages property through the city.

The Family Management Project designed by Grace Hill House to help stabilize multi-problem family units by providing a wide range of social services on an intensive basis while housing the family in standard housing has been quite successful. The agency has also developed a Homemaker Counseling Training and Credit Counseling Program for families who will occupy new and rehabilitated housing.

The majority of the staff employed by Grace Hill House live within the area the agency serves.

The Housing Corporation retained some of the most capable consultants, they are: Hellmuth, Obata, and Kassabaum Architectural Firm, Richard Hetlage of Peper, Martin, Jensen, Maichel, and Hetlage Law Firm, Shelby Pruett of Development Resources, Inc., and Millstone Construction Company.

Grace Hill House merged with three other settlements in January of this year in order to provide and deliver wider services to St. Louis neighborhoods. They formed Consolidated Neighborhood Services, Inc.

Neigrborhood residents have been extensively involved in planning and implementing of programs for the area. A comprehensive plan for the district has been completed, and approved by St. Louis City Plan Commission.

Murphy-Blair is located on the near north side of St. Louis and is bounded by Cass Avenue, Salisbury, 20th Street, and the Mississippi River. The area is inhabited by approximately 14,000 residents—many of whom are considered low income. It is integrated with approximately 40% Black and 60% White residents who are striving to preserve their community. Most of the housing is renter occupied and was built during the early 1800's.

Due to the age and condition of most of the housing in the area, one of the immediate needs of the area is to improve housing conditions. This can be accomplished through the improvement of existing structures and building of new ones. This is the goal of the Murphy-Blair Resident Housing Corporation and Grace Hill Settlement House. The Housing Corporation was formed in 1968. The majority of this Board is composed of residents who live in the community with representation on the Board from the larger community. The groundwork for the formation of the Housing Corporation was laid through the early planning of Grace Hill House, the Non-Profit Housing Center of Urban America, Inc., Hellmuth, Obata, and Kassabaum, and, most importantly, by hundreds of neighbors in the area.

The comprehensive plan developed by the Grace Hill House and the Housing Corporation after its incorporation in 1968 has been approved by the St. Louis City Plan Commission and provides for additional and improved neighborhood facilities, expansion and improvement of the business district, development of a commercial district, as well as the creation and improvement of housing.

Although the Corporation learned early in 1969 from HUD that funds were available under the 221(d)(3) Program and then began working with HUD to process and get approval of the first 124 housing units in the Murphy-Blair South Redevelopment Area no Conditional Commitment for mortgage insurance has yet been issued. The Corporation has control of all the land on the 5½ acres and all families have been relocated. Board members and neighbors feel they are caught between HUD, the City of St. Louis, local and national politics. The Housing Division of Grace Hill receives 40–50 inquiries per week from residents who want to know "when the new housing will be built?"

Nearly four years have been invested in the Murphy-Blair South Redevelopment Project and considerable financial investment. Many families who have been displaced look forward to returning to the area; some have relocated on a temporary basis and have become quite anxious as housing does not materialize.

Grace Hill House and Murphy-Blair Resident Housing Corporation have met all the requests of HUD. HUD issued a Letter of Feasibility which approved the basic plan; the Corporation made all the changes requested by HUD. A letter dated April of this year giving approval of the Murphy-Blair South Project was prepared by HUD, but the letter was never mailed from that office.

Prior to July of this year staff and Board members were given various reasons "off the records", and other reason "on the record" why their "hands are tied". They blame the City—particularly the present administration. They blame the business community for not making more of a commitment to the cause of stabilizing the community and remaining in the city. Some of the main complaints are of "high development cost". "high density", "lack of involvement by private institutions and business sectors", and "insufficient supportive services" for housing planned for area. This is a lot of hog-wash to put it mildly! The Murphy-Blair area is perhaps one of the few areas in the city which has a viable business district within—the 14th Street District, access to major points of public transportation, social service agencies; there are churches of most major denominations, participation of residents of the area, business and industry, and several public schools.

In a presentation to HUD staff on July 13th, Grace Hill staff and consultants explained that Murphy-Blair is more than 124 units of proposed housing. It is a community, with all the necessary amenities, involvement, and supportive services to make it a viable community. The 124 units of housing is only the beginning of the total development plan to rebuild housing and public facilities in the community. The Federal Government is *not* being asked to do it all, but they are being asked to help before the community reaches total decay.

It must reexamine its priorities, and the bureaucratic ineptitude display by HUD officials. As George Speer, President of Northwestern Bank and Trust Company which is located in Murphy-Blair, recently said "unless something happens positive with regard to housing in this area, the businessmen are not sure how long they can remain." In light of this it is easy to see why housing must happen in Murphy-Blair.

ATTACHMENT 2

FACT SHEET MURPHY-BLAIR SOUTH REDEVELOPMENT AREA—PHASE I

The purpose of this sheet is to give you the facts on what actions have been taken to-date to build 124 units of housing in the area known as Murphy-Blair South.

1. November, 1968 the housing committee/Grace Hill House retained Richard Hetlage of Peper, Martin, Jensen, Maichel, and Hetlage Law Firm. Housing Corporation formed same year.

2. January, 1968 Grace Hill Settlement House and Hellmuth, Obata, and Kassabaum, Inc., Architects began working with the local housing committee to determine how to best improve housing conditions in the area.

3. January, 1969 after feasibility study and upon recommendations of Urban America, Inc., and Hellmuth, Obata, and Kassabaum a 9 block Redevelopment Area known as Murphy-Blair South was selected.

4. March, 1969, Land Use Plan for Murphy-Blair was completed and approved by the Board of Aldermen.

5. April, 1969—April of that year the Corporation went to the Land Clearance Authority and got an agreement from LCA that it would go to the Board of Aldermen on its behalf.

6. July, 1969—July of that year Murphy-Blair South Redevelopment Plan was approved by the St. Louis Board of Aldermen and signed into law.

7. 1969, September Millstone Construction Company selected as contractor.

8. 1969, April—Discussion with HUD with regard to program that would best meet need of existing income groups. It was determined with HUD that the 221(d)(3) Rent Supplement Program best suited need. However, we could not make the project feasible at that time because of the prevailing interest rates.

9. 1969–1970 informal discussions with FHA continued.

10. 1970, August—Corporation submitted for informal review a mortgage insurance application for 124 units of housing.

11. 1970, December, a revised mortgage insurance application filed for informal review.

12. 1971, February, meeting with HUD officials to discuss housing proposal.

13. 1971, March—LCA accepted proposal of Murphy-Blair Housing Corporation for development of project and named the Corporation official Redeveloper for the 9 block area. Corporation and LCA entered into contract to acquire remaining properties which had not been acquired by direct negotiation.

14. 1971, May—Formal application for feasibility for 124 units filed with HUD. Figures received from HUD officials were used.

15. 1971, June—Corporation advised by HUD that processing had been completed.

16. 1971, August—Corporation advised by HUD that environmental statement would have to be filed. This was done in mid-August.

17. 1971, August 20th—Letter of Feasibility issued by HUD to Corporation approving basic plan for 124 units. Corporation invited by HUD to submit an application for Conditional Commitment.

18. 1971, Certification received from City Comptroller indicating tax abatement would be available to project.

19. 1971, October—Corporation advised that HUD would have to make adjustments in construction cost in inner city. Corporation's cost figures were the same as those on another inner city project previously approved by HUD. Elmer Smith St. Louis HUD Director, advised Corporation to file an application for a Conditional Commitment. Corporation revised figures to include operating cost estimates made by HUD officials.

20. 1971, November—Based on HUD's intention to make adjustments in construction cost for the inner city an application for Conditional Commitment was filed. A filing fee of $3,795.00 was paid.

21. 1972, February—Without notification from HUD, but on inquiry by Corporation it was learned that HUD would issue Conditional Commitment if brick veneer were added. (Previously, HUD had approved the architectural plans without brick).

22. 1972, February—$50,000 grant received to cover cost of brick veneer.

23. 1972, February 23rd—Corporation advised HUD that all changes would be made and requested issuance of Conditional Commitment.

24. 1972, April—HUD officials verbally advised Corporation that Conditional Commitment was approved.

25. 1972, May—Attorney advised by Mr. Molitor of HUD that Mr. Elmo Turner, Director had instructed his staff to issue Conditional Commitment. Mr. Molitor advised it would be issued by mid-week.

26. 1972, May 16th—Mr. Schram of HUD asked that new Affirmative Marketing Form be submitted. This was done and hand delivered to HUD.

27. 1972, May 22nd—Attorney advised by telephone by Mr. Molitor that the Conditional Commitment had been typed but the Director *could not* sign it.

28. 1972, June—HUD requested reduction from 124 units to 100 units.

29. 1972, July 13th—Mr. Elmo Turner, Director promises decision on Murphy-Blair South before September or October of this year. It has not been received.

30. 1972, May–September—Several meetings held with HUD staff and Corporation consultants, many pieces of correspondence have been sent back and forth. Corporation submitted a revised application meeting HUD request for reduction to 100 units.

Notes

Project approved by City Plan Commission, and St. Louis Board of Aldermen.

54 parcels of land acquired for $150,000.

30 families relocated from acre over two-year period at approximate cost of $200,000.

All buildings on three square blocks have been demolished at cost of $20,000.

Five and one-half acre site is ready for construction.

The MBRH Corporation, Grace Hill Settlement House, the attorney for the Corporation, and the architects have already contributed $60,000 worth of work to this project.

Chairman Proxmire. Mr. Brownstein, please proceed.

STATEMENT OF PHILIP N. BROWNSTEIN, FORMER COMMISSIONER, FEDERAL HOUSING ADMINISTRATION

Mr. Brownstein. Thank you, Mr. Chairman and members of the subcommittee. It is a pleasure for me to be here this morning. Clearly, a point of general agreement in considering what the various commentators, public and private, are saying about the housing problems is the crucial role subsidies now play in the housing market and, in turn, in our entire economic structure.

Also, it would seem that housing subsidies in some form are here to stay. There would be little logic in turning back the clock and getting the Government out of the housing business. We have moved beyond that point. But some voices in the opposite direction are beginning to be heard. We have now had 3 years to work inside the framework of the 1968 housing legislation which for the first time quantified the housing goal for the United States, and we are now testing the Government subsidies on a somewhat massive scale, and evaluating their successes and deficiencies.

The programs have been diagnosed in various ways—some pointing to the successes, but most only to the failures. They have been designated by some as the final solution to our housing ills and at the same time, made the scapegoat by others for the problems which have surfaced. In my judgment, such diverse reactions are directly related to the increasing successes of these programs. Stated another way, the 235 and 236 programs have become victims of their own success. Annual production of subsidizing units has increased ninefold since 1968; mortgagees are now willing to make funds available for these projects; sponsors are plentiful; and demand for the units continues.

Granted deficiencies exist in the existing subsidy programs and

there is ample room for improvement including experimentation with new concepts; nonetheless, it is vital to any charting of future housing goals that these programs be examined in terms of the advantages and achievements as well as the deficiencies. Too often the emphasis has been placed on the latter.

In the last 3 years, primarily because of the section 235 and section 236 programs, we have provided more homes for low- and moderate-income families than were provided in the entire period from 1940 to the present.

Housing starts under the section 235 program in fiscal 1972 are expected to total over 183,000 units and housing starts under section 236 are expected to total more than 118,000 units. At the end of March 1972, some 2 million individuals occupied 235 and 236 subsidized units.

Unquestionably, as these programs are enjoying increased successes in terms of providing shelter for low- and moderate-income families, they are requiring greater levels of Federal funding. Commitment of Federal dollars to housing subsidies currently reaches $1.4 billion annually and some have estimated that long-range funding commitments might reach $7 billion or more by 1978. While that estimate probably is excessive, and may be overstated by as much as 20 percent, the fact is that the programs will cost substantial sums.

This interplay of rising costs and rapidly increasing demands is a shattering statistic to many and in part explains some of the criticisms directed at the 235 and 236 programs. Very simply it is a reaction to the enormity of the task that lies ahead if we are to meet our commitment of providing decent housing for all Americans. It is difficult for many who are accustomed to thinking in terms of 60,000 subsidized units a year, suddenly to shift gears, and start thinking about producing some 700,000 directly subsidized units per year.

Such increased production will require an exacting, massive commitment of our Nation's resources to the task of homebuilding. It will demand a reordering of national priorities to place housing concerns high on our agenda in the seventies.

The successes of a vast majority of 235 and 236 units firmly established the credentials of these programs as a viable instrument for meeting our housing needs. At the same time, there are deficiencies in these programs which should be corrected.

First, the 235 program was designed to bring homeownership within the reach of low- and moderate-income families through mortgage interest subsidies. Many of these families are entirely ready for homeownership and simply lack adequate resources. Experience has shown that where such families acquire a satisfactory house the failure rates are no higher than are those of unsubsidized mortgagors. But there are other low- and moderate-income families who need to be prepared for the responsibilities of ownership and require an effective counseling program.

In failing to provide such services for those who need them and adequately preparing individuals for the responsibilities of homeownership, we have, in many instances, insured high failure rates. It is not enough to provide individuals with the keys to a house, a mortgage payment book, and then walk away. Indeed, such an approach is totally deficient if society expects to benefit from providing homeownership to low- and moderate-income families.

Somehow these low- and moderate-income individuals who, by and large, have been trapped outside the economic mainstream were expected immediately to acquire all the know-how of middle-class homeowners. It just does not work that way. This was recognized in the Housing Act of 1968 in section 101 which authorized the Secretary to provide budget, debt management, and related counseling services to mortgagors whose mortgages are insured under section 235. Unfortunately, these programs were not funded at all initially and have never been adequately funded.

Improvements can also be made in the section 236 program which was designed to provide decent rental or cooperative units. Successes in this program appear to be directly related to the strength of the sponsor. Generally speaking, the stronger sponsors produce the better and more successful projects. Here again, experience has shown that the failure rate is very low where the sponsorship is strong. Clearly, HUD should make every effort to attract those sponsors who have proved their capability of developing sound projects.

A continuing problem in the 236 program has been the underestimation of operating costs. Projects have been approved with unreasonably low-cost figures and later as costs begin to mount rents have to be increased to levels that make the units too expensive for the income group contemplated. Unquestionably, a more critical evaluation of cost estimates is essential and HUD is now focusing on this problem.

It is unfortunate, as was pointed out during Mr. Staats' testimony, that the subsidy programs are being blamed for the housing scandals. The reported pattern in the homeownership program has been for a speculator to buy decrepit structures at distress prices, apply some cosmetic treatment and sell them at inflated prices to unsuspecting purchasers.

Such practices are reprehensive, and corrective measures must receive the highest priority. However, these schemes have been unfairly tied to the section 235 homeownership program. In fact, for the most part they have involved nonsubsidized section 221(d)(2) and 223(e) programs.

Opponents of housing subsidy programs in general, and perhaps those principally concerned about the cost, point to these cases and label housing subsidy programs as failures. They certainly are entitled to be judged on their merits without the issue being clouded with extraneous and inapplicable illustrations which have stemmed from other programs.

In summary, I suggest that while our current subsidy programs are far from perfect they are workable. Deficiencies do exist but they are amenable to corrective measures. I would caution against reform only to escape a difficult problem. Reform by itself does not insure success. The inescapable fact is that providing shelter for millions of Americans who have long been outside the economic mainstream is difficult, costly, and exacting task. And perhaps even more importantly, decent housing alone will not solve the Nation's social ills. It is one of the most important elements in bringing our deprived citizenry into a decent environment. However, it must be considered in context and approached together with better educational facilities;

job training and employment opportunities; health care, et cetera. There are no easy answers or magic solutions.

But as to housing, the critical question for the seventies is our willingness to commit the resources necessary to house low- and moderate-income families. Until we are willing to make such a commitment, until we are willing to re-order national priorities and make adequate funds available, a successful housing program will elude our grasp.

Mr. Chairman, I would now like to mention three points that were covered by Mr. Staats during the course of his testimony.

First, in dealing with the matter of incentives in the 236 program, I think that the question raised by Congressman Conable is a very appropriate one and that is, unless there are adequate incentives, and I am not here saying what those incentives are or should be, they will not induce investors to sponsor low- and moderate-income housing. There has to be an incentive if we are to get this housing produced. If the incentives are watered down so as to lose their attractiveness, the program is bound to falter.

Second, it was mentioned that projected at the present rate there may be foreclosures in the section 235 program of as much as 10 percent by 1978. That would mean that there is a 90 percent success rate which I think is remarkable. I do not know that the 10 percent foreclosure rate is a valid one, and a price tag was attached which was very significant and I do not intend to minimize it. But you are here dealing with a group of people who could not qualify for homeownership without a subsidy. If 90 percent of those prove to be successful, I would have to say I think it is a very successful program, with great social benefit.

The third point that I would like to comment on is that it would have been much cheaper to have made the loans direct rather than to subsidize the interest rate. Unquestionably, this is true. I do not know whether the figures that were given here are accurate but I will not question them. But I think that the chairman's point was the appropriate and applicable one and that is until this Nation is ready to accept a capital budget you will get absolutely no volume of housing production by having direct loans. With the problems of getting an authorization through the Budget Bureau and through the Congress the volume of production would be absolutely minimal. As a matter of fact, we had in effect a direct loan program, the 221(d)(3) below market interest rate program which was enacted in 1961. It was changed to the interest subsidy program of 236 for this very reason and until, Mr. Chairman, we do accept a capital budget concept, thus avoiding having every loan connected as a budget expenditure, there will be no volume production, except through the interest subsidy.

Thank you very much.

(The prepared statement of Mr. Brownstein follows:)

Prepared Statement of Philip N. Brownstein

Mr. Chairman and members of the committee: It is a pleasure to appear before this committee to discuss the question of Federal Housing Subsidies and Housing Policy.

I have read with considerable interest the report entitled "The Economics of Federal Subsidy Programs" which was prepared for this committee I have also followed recent commentators, both public and private, in their continuing debate on the future of our housing policies.

Clearly, a point of general agreement is the crucial role subsidies now play in our housing market, and in turn, in our entire economic structure. Also, it would seem that housing subsidies in some form are here to stay. There would be little logic in turning back the clock and getting the Government out of the housing business. We have moved beyond that point. But some voices in the opposite direction are beginning to be heard.

Traditionally, our housing market had two basic components:

First, those who could afford to pay the cost of decent housing production;

Second, those low- and moderate-income families who could not afford standard housing without some assistance.

As a general propostion, the housing industry responded well to the first demand. Unquestionably, we are the best housed nation in the world in terms of overall quality of housing and also in terms of proportion of housing units to population.

For the other group, however, the low- and moderate-income family—our housing industry has been unable to provide decent housing at prices they can afford. With inflation in building costs and skyrocketing land costs caused by the shrinking of suitable sites, the gap between what this group can pay and what the market demands has widened and will undoubtedly widen further.

Acceptance of these basic economic facts was a rather slow process in this country. Each new HUD program highlighted the housing needs of the economically disadvantaged and focused attention on possible solutions. Then in 1968 with the passage of the Housing and Urban Development Act this country set a housing goal to provide 26 million units over a 10-year period, and committed some form of housing subsidies to 6 million of those units. For the first time, meaningful housing subsidies were authorized in significant volumes.

We have now had 3 years to work inside the framework of that legislation—to test Government subsidies on a massive scale and to evaluate their successes and deficiencies.

These programs have been diagnosed in various ways—some pointing to the successes, but most only to the failures. They have been designated by some as the final solution to our housing ills and at the same time made the scapegoat by others for the problems which have surfaced. In my judgment, such diverse reactions are directly related to the increasing successes of these programs. Stated another way, the 235 and 236 programs have become victims of their own success. Annual production of subsidized units has increased ninefold since 1968; mortgagees are now willing to make funds available for these projects; sponsors are plentiful; and demand for the units continues.

Granted deficiencies exist in the existing subsidy programs and there is ample room for improvement including experimentation with new concepts; nonetheless, it is vital to any charting of future housing goals that these programs be examined in terms of the advantages and achievements as well as the deficiencies. Too often the emphasis has been placed on the latter.

In the last 3 years, primarily because of the section 235 and section 236 programs, we have provided more homes for low- and moderate-income families than were provided in the entire period from 1940 to the present.

Housing starts under the section 235 program in fiscal 1972 are expected to total over 183,000 units and housing starts under section 236 are expected to total more than 118,000 units. At the end of March 1972 some 2 million individuals occupied 235 and 236 subsidized units.

Additionally, we are beginning to see some positive statistics with regard to the number of families whose incomes are increasing sufficiently to permit them to begin earning their way out of the subsidy programs. To date, 8 percent have earned enough to go off subsidy programs entirely, while another 65 percent have become financially able to get along with smaller subsidies.

Unquestionably as these programs are enjoying increased successes in terms of providing shelter for low- and moderate-income families, they are requiring greater levels of Federal funding. Commitment of Federal dollars to housing subsidies currently reaches 1.4 billion annually and some have estimated that long-range funding commitments might reach $7 billion or more by 1978. While that estimate probably is excessive, and may be overstated by as much as 20%, the fact is that the programs will cost substantial sums.

Further complicating this situation are projections on future demands for such subsidies. These programs are now reaching only a fraction of the families in need of some housing assistance.

This inter-play of rising costs and rapidly increasing demands is a shattering statistic to many and in part explains some of the crlticisms directed at the 235 and 236 programs. Very simply it is a reaction to the enormity of the task that lies ahead if we are to meet our commitment of providing decent housing for all Americans. It is difficult for many who are accustomed to thinking in terms of 60,000 subsidized units a year suddenly to shift gears and start thinking about producing some 700,000 directly subsidized units per year.

Such increased production will require an exacting, massive commitment of our Nation's resources to the task of homebuilding. It will demand a re-ordering of national priorities to place housing concerns high on our agenda in the seventies.

The successes of a vast majority of 235 and 236 units firmly established the credentials of these programs as a viable instrument for meeting our housing needs. At the same time there are deficiencies in these programs which should be corrected. In this regard, it is important to distinguish the 235 and 236 programs. Many have lumped these programs together and referred to them as the housing subsidy program.

First, the 235 program was designed to bring homeownership within the reach of low- and moderate-income families through mortgage interest subsidies. Many of these families are entirely ready for homeownership and simply lack adequate resources. Experience has shown that where such families acquire a satisfactory house the failure rates are no higher than are those of unsubsidized mortgagors. But there are other low- and moderate-income families who need to be prepared for the responsibilities of ownership and require an effective counseling program.

In failing to provide such services for those who need it and adequately preparing individuals for the responsibilities of homeownership, we have, in many instances, insured high failure rates. It is not enough to provide individuals with the keys to a house, a mortgage payment book and then walk away. Indeed, such an approach is totally deficient if society expects to benefit from providing howeownership to low- and moderate-income families.

We have failed to offer home purchase guidance for prospective owners as well as basic advice to assist new owners. And we need to offer counseling programs in family budgeting, homemaking, record keeping and even in the operation of household operation of any home. These are so basic that one might question the rationale of operating a homeownership program without the inclusion of counseling services.

Somehow these low- and moderate-income individuals who, by and large have been trapped outside the economic mainstream were expected immediately to acquire all the knowhow of middle-class homeowners. It just does not work that way.

The Housing and Urban Development Act of 1968 recognized counseling was an essential ingredient in achieving the social objectives of the housing goals. Section 101 of that act authorized the Secretary to provide budget, debt management and related counseling services to mortgagors whose mortgages are insured under section 235. Unfortunately, these programs were not funded at all initially and have never been adequately funded.

In addition to the need for homeownership preparedness, other improvements in the 235 program deserve consideration. Care must be exercised to make certain that the house will not require some major repair item shortly. Even the cost of a new water heater could put the case in jeopardy. The counseling should include an examination of the prospective homeowner's ability to cope with problems of this nature.

Improvements can also be made in the section 236 program which was designed to provide decent rental or cooperative units at a cost which low- and moderate-income families could afford. Successes in this program appear to be directly related to the strength of the sponsor. Generally speaking, the stronger sponsors produce the better and more successful projects. Here again, experience has shown that the failure rate is very low where the sponsorship is strong. Clearly HUD should make every effort to attract these sponsors who have proved their capability of developing sound projects to the 236 program. Also critical to a successful 236 project is highly skilled management to operate the project once it is completed. Recently HUD has been focusing on this problem and I would hope we will see some significant improvements in the near future.

A continuing problem in the 236 program has been the under-estimation of operating costs. Projects have been approved with unreasonably low cost figures

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and later as costs begin to mount rents have to be increased to levels that make the units too expensive for the income group contemplated. Unquestionably a more critical evaluation of costs estimates is essential and HUD is now focusing on this problem.

At the same time, this problem raises the issue of a need for deeper subsidies. Here, the use of rent supplements with more 236 units might be considered to reach those families who cannot afford higher rentals.

While the above are clearly needed improvements in the 235 and 236 programs, I would again urge that these deficiencies, many of which are administrative in nature, not be used as a broad brush indictment of the 235 and 236 programs.

It is particularly unfortunate that the subsidy programs are being blamed for the "housing scandals" which have been receiving so much attention. The reported pattern in the homeownership program has been for a speculator to buy decrepit structures at distress prices, apply some cosmetic treatment and sell them at inflated prices to unsuspecting purchasers.

Such practices are reprenhensive and corrective measures must receive the highest priority. However, these schemes have been unfairly tied to the section 235 homeownership program. In fact, for the most part they have involved non-subsidized section 221(d)(2) and 223(e) programs.

Opponents of housing subsidy programs in general, and perhaps those principally concerned about the cost, point to these cases and label housing subsidy programs as failures. They certainly are entitled to be judged on their merits without the issue being clouded with extraneous and inapplicable illustrations which have stemmed from other programs.

I have devoted the major portion of my testimony to existing subsidy programs in an effort to place them in perspective, since most of the attention has been devoted to what is wrong with the programs disregarding the large number of families who are now living in decent shelter solely because of them. I would, however, like to comment briefly on a proposed alternative to the current subsidy programs, that is the adoption of a housing allowance program.

Housing allowances clearly have a role to play in any scheme of Government subsidies for housing. For example, such an allowance program would be especially appropriate in areas where there is an abundant housing supply and where new construction is not needed to meet the housing demands. However, I would question the advisability of housing allowances in areas where the existing housing stock cannot adequately meet current demands of low- and moderate-income consumers. To provide housing subsidies in such communities would simply increase inflationary pressures on prices and rents of existing units.

It is my understanding that in cities with inadequate housing supplies where housing allowances are presently being tested, the major problem encountered is rental increases. It is indeed defeating to provide housing allowances so landlords can charge higher rentals for the same units.

Also, to be considered is the overall impact of housing allowances on production levels. The goal for six million subsidized housing units was premised on an identifiable need for those units. Under current programs, sponsors are encouraged to meet production goals by assurances of the availability of financing and availability of tenants for their projects upon completion. Without such assurances, I question the willingness of mortgagees to commit sufficient funds and the willingness of sponsors to undertake construction of high risk projects.

Finally, I have some basic concern over long range costs necessary to implement an adequate housing allowance program. Granted some cost projections appear reasonable but upon closer examination of the dollar figures and the numbers of families to be served the subsidies per family seem to be extremely low. Thus, any consideration of a large scale housing allowance program should include a judicious review of the cost factors.

While cautioning against the acceptance of housing allowances as the panacea of our housing ills, I would agree with the approach proposed in the study prepared by Dr. Schecter. He suggested that more precise knowledge about a housing allowance program is needed and how it would operate under different market conditions so that it might be employed selectively.

In summary, I suggest that while our current subsidy programs are far from perfect, they are workable. Deficiencies do exist but they are amenable to corrective measures. I would caution against reform only to escape a dif-

ficult problem. Reform by itself does not insure success. The inescapable fact is that providing shelter for millions of Americans who have long been outside the economic mainstream is a difficult, costly, and exacting task. And perhaps even more importantly, decent housing alone will not solve the Nation's social ills. It is one of the most important elements in bringing our deprived citizenry into a decent environment. However, it must be considered in context and approached together with better educational facilities; job training and employment opportunities; health care, etc. There are no easy answers or magic solutions.

But as to housing, the critical question for the seventies is our willingness to commit the resources necessary to house low- and moderate-income families. Until we are willing to make such a commitment, until we re willing to reorder national priorities and make adequate funds available, a successful housing program will elude our grasp.

Chairman Proxmire. Thank you very, very much, all of you gentlemen. These are certainly superlative statements in every case, I was informed, and very much impressed. I think you made a fine record.

I would like to ask each of you other gentlemen, Mr. Katz and Mr. Smart, to comment on this last point by Mr. Brownstein, that was my first question, whether or not you would favor shifting to direct loans to finance the 235 ownership and 236 rental subsidies in view of the estimated savings that we just heard of $2.2 billion between now and 1978.

Mr. Katz. The program suggested, if it is changed, as Mr. Brownstein indicated, we would be going back half a decade when we did have a similar program. It was changed because the annual capital outlay was so enormous and reflected itself in the budget. If bookkeeping is such that this could be acceptable it is not dissimilar to that which the State housing authorities are now involved in, the sale of tax-exempt securities, and passing the interest savings on to the tenants in lower rents. In Wisconsin, the current quotation from one of the large underwriters is 5.35 percent, we will add on one-half of 1 percent and our loans will be approximately 6 percent. Six percent interest for $150 million of mortgages will create something like 700,000 housing units in 2 years time.

What is being suggested is a similar program on a national level. If bookkeepingwise we can avoid this concept of a capital expenditure in the annual budget to be paid back over 40 years, then it would be successful and I would agree to it.

Mr. Smart. I have a recommendation here we do just that. I recognize the point Mr. Brownstein makes. I was involved in it at that time. I do think, though, if we could find some means of developing a housing trust fund similar to this highway trust fund, that it might get it out of that problem.

Chairman Proxmire. Well, it is a fascinating suggestion. The trouble is there are two problems: One, a lot of us are concerned about the highway trust fund. It isolates revenue regardless of need and, one way or another, if we need more or less, that is it and, of course, the highway trust fund is a natural, you have the gasoline tax directly related to people who use the highways and I cannot think of anything that is comparable with respect to homeowners, maybe there is something.

Mr. Smart. Right, but it did get the job done.

Chairman Proxmire. It gets the job done, but as I say, it is a special user tax.

Mr. SMART. Right.

Chairman PROXMIRE. Now, let me ask all of you gentlemen about this, too. I have a copy of what is alleged to be a September 1972 HUD memo written by Mr. William Whitbeck,[1] the HUD area director for Detroit, making some serious criticisms of HUD's management of housing programs. I would like both of you to comment on the following criticisms taken from the memo:

(1) Since HUD has apparently made no comprehensive analysis of the reasons for default in its homeownership programs, would each of you please give us your analysis of the major factors that have contributed to such high default rates?

Mr. Katz.

Mr. KATZ. From my own frame of reference and experience in Wisconsin we have not had a high default rate but my knowledge as to what has happened around the country the default rate is one——

Chairman PROXMIRE. I wanted to know about your own view, especially with respect to Detroit.

Mr. KATZ. In Detroit the reasons were: One, poor underwriting; two, the use of fee appraisers in the inner city of Detroit, men who were not able to cope with or understand the problem and what was expected of them in appraisals.

Three, the use of appraisers in property that needed massive rehabilitation and they were totally unqualified as appraisers to determine the amount of rehabilitation necessary. What you needed were inspectors who had skill in construction. An appraiser looks at a piece of property, determines its value, and can note minor deficiencies. He is not skilled in determining the adequacy of many of the components of the unit and this was one of the errors in Detroit, and I was aware of it because of my involvement with the Secretary earlier this year.

Four, I think we had a people problem in Detroit. It was not housing per se that was at fault. People who did not have an insured mortgage, people who had sufficient equity in that unit because they may have owned it for 12 years' time, abandoned their houses because of fear in the streets, of fear of having their kids walk to and from school and be mugged, a fear that they could not leave their homes for a weekend without having them broken into. If you look at pictures of Detroit housing you will see wire fences in the front and backyards to keep people out, without success.

So there was fear in the streets, abandoned homes used by drug addicts and criminals; fires were started in these abandoned homes. It was just an unsafe, terrible area. Detroit has a "people" problem, and it was not housing just itself, that was responsible for all this.

Chairman PROXMIRE. You are talking about a crime problem.

Mr. KATZ. Crime, if you will, and poor schools. How many good schools are in that inner city of Detroit? How much effort was there by the city of Detroit to rehabilitate old school buildings and make them modern and acceptable?

Chairman PROXMIRE. How does that differ from any other impacted area, Detroit would not be different from Newark.

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[1] See memo written by Mr. Whitbeck beginning on p. 264.

Mr. KATZ. Not dissimilar from Newark, St. Louis, Wilmington. On the other hand, other cities did try to resolve it, with good schools, adequate police protection, good lighting. The problem is attacked by many communities—success is a matter of degree.

Mr. SMART. I would have to say there is no large city in the United States where we have a ghetto and slums where we have resolved those problems. I think they are pretty similar across the board. I think there are several keys you can look at. One, of course, is the objective you are trying to achieve and without the program, without some control, I would have to suggest some criminal reasons as to why the program failed in Detroit. I think any program, medicaid, housing, or anything where the opportunity to make a big buck is there, this is precisely what the people are going to do rather than try to live within the service. So that was the objective. There was no control over it. I cannot say that an appraiser could look at a $2,000 house and come up with a price of $14,000 on it as a mistake. I think this was a deliberate effort for which he was obviously very well paid and there were no controls, not in the community, not in the city, not in the HUD program.

Chairman PROXMIRE. You say it goes to more than just inefficiency and incompetence, it is a matter of criminal intent?

Mr. SMART. Absolutely, absolutely. Opportunity to maximize profits and get the most that one could get out of it, and I do not see any control of that except coming out of the community itself.

Chairman PROXMIRE. Mr. Brownstein.

Mr. BROWNSTEIN. I have no personal knowledge, Mr. Chairman, of what caused this in Detroit, Mr. Katz has gone over the reasons that he believes, based on his experience.

There is one added dimension that I might suggest and that is that this has sort of a cancerous effect. If default occurs and foreclosure happens on property in a very difficult area such as some of these ghetto areas in Detroit, the house is vacated, the undesirables move in, cannibalize the place, take everything that they can sell. The dope addicts, the winos are there, the family next door is not going to live in that kind of an environment and so they are going to get out, and I think that it just moves on right down the street.

Mr. KATZ. May I add this, Mr. Chairman?

Chairman PROXMIRE. Yes.

Mr. KATZ. I think it goes back 5 or 6 or 8 or 10 years in HUD and FHA. There is a basic concept that when we underwrote homes wherever, we were protecting the Government of the United States and no one else. The concept was that a prudent buyer meets a knowledgeable seller in the marketplace, negotiates a deal and the underwriting by the FHA was to protect its interest in that mortgage.

This was an erroneous concept that was nationally promulgated and, frankly, at some time in the past decade there should have been an awareness that we do not have a knowledgeable buyer in that marketplace, and that we must not merely protect the Government of the United States, that we have to protect the buyer, because if we protect him we will be protecting the Government.

In 1965, 1966, 1967, and 1968, when the pressures were on to get rehabed housing into the inner city, we had to train our people to protect the buyer, we had to come up with programs at that time, of

counseling and concern. To protect the Government we in turn, had to protect the home buying families. This is what we did in Wisconsin.

Chairman PROXMIRE. You say in Milwaukee where you had, of course, a smaller impacted area but you had a very similar problem, you avoided this problem by intensive counseling, by intensive training. Do you feel that you were also tougher, that you had to turn down some people who needed housing and perhaps you might have shaded a little bit and given them housing where they were questionable?

Mr. KATZ. I do not think we turned any more people down creditwise than any other office did but we were concerned with the condition of that property early in the game and the rule was, to use our own appraisers and our own inspectors. Every house in the inner city if it was in need of massive repair, had an inspector teamed up with the appraiser and they were both staff people to be sure that the list of requirements was made.

Two, when it came to a welfare mother, all she received was a shelter allowance for rent and in 1967 Government says, "She can use this for a housing purchase." The simple question we asked was: "where is repair money coming from?" She was on a strict budget, so much for shelter, so much for clothing and food, et cetera. She had no overage of dollars for repairs, we did not underwrite a single welfare mother's home unless the county welfare department would guarantee the repairs out of its budget, and that is what happened there.

Chairman PROXMIRE. Does it not mean some welfare mothers who wanted homes were turned down? What did they do?

Mr. KATZ. If they were turned down it was because the welfare department did not recommend them for home ownership based on their own observation of their poor housekeeping experience. Only those who appeared to have the upward mobility were recommended by the supervisor in the welfare department to FHA and only those were underwritten. We had to have a written statement of guarantee of repairs and also recommendation from the welfare department.

Chairman PROXMIRE. The others were put into rent units with rent supplement?

Mr. KATZ. They were put into conventional rental units by the welfare department and they paid the rent, as they are still doing all over the country and in Milwaukee.

The Welfare Department also developed a training program both prebuying and postbuying. They paid money to the mother to come to classes, they provided a baby sitting service and they gave them a gift of tools when the program was over.

They also had housing aides go into the home every 3 months to see what the condition of that home was after the mother moved in, to be sure that a small repair did not become a big repair. We had nine communities in Wisconsin that accepted this program.

Mr. SMART. May I add to that point of a knowledgeable buyer in which I agree with Mr. Katz, I would like to add the point which I think perhaps is more important: that is, the buyer having no choice. I think many of the buyers recognized certain deficiencies in homes in Detroit in that 235 program, none of them, I believe were told this was a 235 Government program that offered certain advantages to

you. I think more likely that the speculator said, "I will work the problem out with you. Here is a home."

Now, recognizing there are certain deficiencies there, with no other choice, no other place to go; as long as you have got a captive population like that, and I would say it is very large, then programs like this are going to be exploited without the controls, without the proper kind of counseling.

Chairman PROXMIRE. Let me ask before I yield to Congressman Blackburn, is it true that HUD has paid very little attention to marketing and managing Project Rehab rehabilitated structures and as a result it is highly probable that most of these mortgages will soon go into default?

Mr. SMART. Well, the one which I am familiar with is 70 percent in default right now, and again I do not think it is totally because of HUD. I think the major problem is that there are certain unique conditions within the ghetto area that will require other levels of responsibility. I do not think HUD can carry it all. I think it is their lack of knowledge about this other layer of responsibility that is at fault.

So that if, within those communities, we could have had some technical assistance being provided at that level of control to provide some of the management or supervision then I think the program would have been successful.

Chairman PROXMIRE. Do you have any observations on that, Mr. Brownstein or Mr. Katz?

Mr. BROWNSTEIN. I really have no personal knowledge of it, Mr. Chairman.

Mr. KATZ. We have had little or nothing in the way of rehab. Rehab works only in those communities where the cost of acquisition is low and then and only then does rehab make economic sense. In Wisconsin cost of acquisition of older property is extremely high and rehab programs are not feasible.

Chairman PROXMIRE. Mr. Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman. I want to say that this testimony that I received is very enlightening and most stimulating, and I think that the main message I have from all of your testimony is the fact that housing and the problem of providing housing to low income families cannot be dealt with separately from the total environment in which we are dealing, and the thought of families with the substantial equity in housing moving out and abandoning a house because no one would buy it and they do not want to live in that neighborhood themselves is a rather shocking thing to have to face. I have heard Secretary Romney often make the observation that it is unfair to the man for the Department of HUD to deal with only housing problems, when the problem is more deep than that because of the other social problems in a community.

I know in your statement, Mr. Smart, that you deal with a typical welfare family where you have a female head of the household with four or five children. This raises a problem in my mind. What do we do about the father? I sympathize entirely with the children and their problem. I have some sympathy with the mother. I have far less with the father of those children. What can the Government do to impress

upon the father of children that they have responsibilities toward those children? Perhaps that will relieve a lot of us of some of the burdens we are facing here today.

Mr. SMART. Well, I do not know if I can give you a direct answer. My belief is that if we open up some employment opportunities in those areas so that the male head of a household can support that family with some sense of dignity, I think the families would keep together. In all of my experience, and I at one point worked with about a thousand families a year over a period of time, this seemed to me to be the major difficulty, not being able to stay there and provide that kind of responsibility. Many of the fathers I worked with had a bring-home pay after a full week's work that could hardly even pay the rent, and if he left the home, of course, the family is supported by welfare, they are a little bit better off.

Representative BLACKBURN. We built in an incentive for a father to desert his family.

Mr. SMART. That is right.

Representative BLACKBURN. It would be better off economically to abandon it than if he stayed there.

Mr. SMART. Right.

Representative BLACKBURN. Thank you, gentlemen. I have other commitments. I do appreciate your taking your time though, and giving us the benefit of your experiences.

Chairman PROXMIRE. The hour is late. I do have a few questions I would like to ask, you are such an excellent panel. Is it true, Mr. Katz, that HUD's communication system between the central offices and the field offices is flooded with procedure items and few substantive policy inputs from the field up? Is it also true that HUD has done very little to improve its evaluation and early warning capacity?

Mr. KATZ. You have got a vast field of questioning there. Let me, and I am not so sure I will be responsive to the specifics of that question, but if I can put my finger on what I think is a problem in HUD, it is not necessarily the directorships. The director of Milwaukee, for example, is an able man, he is a good professional and we are very pleased. I think the problem that we have been running into, which has arrested the delivery of housing multifamily from 4 to 5 months to a year or a year and a half, is due to the decentralization process which has taken people out of central office or from the outside and placed them into second, third, and fourth and fifth positions from the top without experience in the specific jobs they were supposed to do.

Let me give you what I think is an analogy to illustrate the heart of it. If anyone has an IRS problem, a businessman, an individual, he would hire a good lawyer who understands taxes and would go to the IRS office, and chances are, across the desk, the IRS representative would know as much about taxes as his lawyer does or he does, and they would get results. They would resolve the problem.

If a businessman had a labor relations problem he would get a good labor lawyer, go to the National Labor Relations Board office, and chances are that the representative of the National Labor Relations Board sitting across that desk knows as much about labor law as his lawyer does, as he does, and they get results.

If you were to go to many of the HUD offices today, the wise, the knowledgeable sponsor-builder would find that the man sitting across that desk knows much less about housing than he does. The HUD representative is not the director, the director may know his business but he has other things to do. We are talking about the people in middle management in the HUD office. There are some exceptions, there are some able people. But the new people who have gone in, have gone in without training. They were sent out from regional offices into field offices and filled slots based on their grade; slots that were open due to the new structuring of the office. Men without management experience suddenly found themselves in charge of five or six or eight technicians. Unfortunately, they knew less than the technicians knew. And this is one of the major problems in HUD offices around the country, a condition that has arrested housing production.

Chairman PROXMIRE. That is in direct contradiction to Mr. Staats, a very convincing statement, Mr. Katz. But Mr. Staats said in his view, decentralization was not necessarily a mistake. Maybe he was saying that in his study he had not been able to confirm that particular phase. I am persuaded by your observation.

Mr. KATZ. I am not saying decentralization was a mistake.

Chairman PROXMIRE. The way it was carried out.

Mr. KATZ. The way it was done.

Three years ago I met with a task force in Chicago, a task force that was contemplating the procedures necessary for the decentralization process and I pleaded with them, I said, "don't set a date for the decentralization and say that an office in Milwaukee or Minnesota or Detroit will become operative on a certain day and now we will be all things to all people. Instead build upon the FHA structure, take public housing, only that function, and put it into the FHA office and integrate it—take 3 months; then take college housing and its people and add that on; and then take your other programs, water and sewer grants, et cetera, and add that on, take a year's time and gradual development of an office, build on what you have, and then come up with a delivery system after a year of integration that might be productive."

Instead a date was declared, and HUD announced that an office had become operable, but it was not operable because new people came in and did not know which end was up.

Chairman PROXMIRE. You gentlemen feel that the problem is a matter of management one way or the other. Training, selection, having the right people in the right place, knowing what they are doing, and with sufficient care so that they are competent to do it correctly.

In your prepared statement, Mr. Smart, you describe some private efforts to upgrade housing that have been remarkably successful. The main ingredient in these success stories is able administration.

Mr. SMART. Right.

Chairman PROXMIRE. Would you describe some of these that could be carried over into the Federal program?

Mr. SMART. To be frank, I think it would be a mistake for the Federal Government to attempt to carry out all these roles. For some time until we do, if we ever do, achieve a free and open real estate market, and while we have what I consider captive populations for certain communities, I think it is imperative that those communities become involved in the management and control of some of those programs to make them workable. So, I think it has to be a partnership approach.

I think if HUD or its officers attempt to carry out this function, we are going to get into difficulty no matter what.

Chairman Proxmire. Mr. Brownstein, as I understand it, you believe the two key reforms for the 235 homeownership subsidy are managerial and consist of (1) improved counseling and (2) some method to make certain that the house will not require some repair item right after purchase. You state that HUD has not provided these services—how would you advise the Congress to go about improving these two areas?

Mr. Brownstein. Well, it is going to take some money, Mr. Chairman, and I think what ought to be done is funds should be appropriated for a counseling service in both of these areas, and let me emphasize here that I do not believe that this is a counseling service that can be provided by HUD. It has to be provided by people in the community who have credibility with the people with whom they are dealing, and it is going to take funding in order to achieve this. I just believe this is absolutely critical if these programs are to be successful.

Chairman Proxmire. My final question is in the area of housing allowances because many Members of the Congress and others have proposed this as a practical way to move along and I am very concerned about that. It could be very expensive and not very effective.

Many have expressed reservations about the housing allowance proposal out of concern about limited supply in some markets that you do not build houses that way, and what you say is you need more and more and more construction to approach it. You go beyond the limited supply, though, as I understand it, Mr. Brownstein, you say that such an allowance as a substitute to production subsidies might have a very adverse effect on housing production.

Do you believe the housing production goals established in the 1968 remain an urgent priority?

Incidentally, it was my amendment that provided for the 26 million housing starts over the decade beginning in 1968. You think that does remain an urgent piority?

Mr. Brownstein. I do, indeed. I believe that the goals of 1968 have been, if anything, validated. I am concerned about housing allowances. I think that this is one of the problems. We find there are problems in the existing program so we search out another program. Housing allowances would be, I believe, quite proper in an area where there is an adequate supply of housing, as has been suggested here earlier. But if you go into an area where you already have a tight housing market and all you are doing with the housing allowance is increase the demand for an already inadequate supply and drive up rentals.

Mr. Schechter made this point in his paper and I agree with him thoroughly. I think this is something that ought to be looked at and ought to be tested but I certainly would not suggest for 1 minute that we abandon what, I believe to be, are inherently good programs in favor of this untested mechanism.

Chairman Proxmire. How significantly could a housing allowance depress housing production?

Mr. Brownstein. Well, it would depress it totally, because no developer can afford to take the chance of building a project in the hope

that someone who is eligible will come to him, for if your project is subsidized then he has a built-in market.

Chairman PROXMIRE. Could I ask Mr. Katz to comment on that?

Mr. KATZ. Yes, I voiced my apprehensions in my prepared statement, Mr. Chairman. You know the Milwaukee Southside, you know the impacted Spanish-American communities there, with a tremendous shortage of housing. There are people there who do have housing allowances. They get them from the welfare department which says, "We will give you $135, go out now and find rental quarters, that is what we will allow you." They cannot find the housing. The little they get is frequently substandard. If they went out and said, "Go out and buy housing," they could not afford it even at that price.

Housing allowances would not be much different from how we operate currently with the welfare department, except the housing allowance would be not for those on welfare, it would include those with incomes a notch above. If the housing industry, which takes about a year and a half leadtime to produce housing, was aware there was a need, I suspect they would respond and relate only to the elderly or those without children and not build rental housing for those families with children. They do not want the management headaches. Allowances would probably be all right if we had a surplus housing supply as I think exists in Kansas City, the first city HUD selected for this program.

The existing programs which we used in your own State, Mr. Chairman, solved a housing shortage in the Fox River Valley in 1968, 1969, and 1970. In the Lake Winnebago area, from Green Bay down we had an abject housing shortage. Today there is a balance housing supply. The 235 program went in there with excellent housing programs in all communities, Neenah, Oshkosh, Winneconne. It produced housing for families with children, and made existing two-bedroom apartments available for newly married couples. Today we have a slight vacancy factor in the area, and the housing supply is healthy. We do not need more housing in that area except housing for sale.

Chairman PROXMIRE. It is a 10 strike in that area because I was very much aware of that housing shortage.

Mr. KATZ. It was predictable and, given 235 the builders jumped on board there and did a splendid job. The result today, 4 years later, is a solved problem accomplished with the use of 235 assistance with some 236 apartments cranked in.

I submit in the large urban communities, shelter allowances, housing allowances, in cash will not have a good effect. It will have an adverse effect.

Chairman PROXMIRE. Gentlemen, I want to thank you very much. We could go on at great length because you did a fine job in your presentation, and I know there is a great deal more we can learn from you but the time has come when we must call it quits.

Thanks for one of the best panels I have heard in a long, long time.

Tomorrow we will hear from Mayor Gribbs of Detroit, Mich.; Henry J. Aaron, economist, the Brookings Institution; Anthony Downs, economist, Real Estate Research Corp.; and Philip I. Emmer, president, Emmer Development Corp.

We will recess until 10 o'clock tomorrow morning, when we will reconvene in this room.

(Whereupon, at 12:45 p.m., the subcommittee was recessed, to reconvene at 10 a.m., Tuesday, December 5, 1972.)

(The following information was subsequently supplied for the record by Chairman Proxmire:)

U.S. Department of Housing and Urban Development,
September 8, 1972.

Memorandum

To: George J. Vavoulis, Regional Administrator, Region V.
From: William C. Whitbeck, Area Director, Detroit.
Subject: Suggested Agenda Items for September 28 and 29, 1972, Regional Administrators' Meeting.

1. *Problem:* In many major cities, defaults on single-family mortgages, mainly unsubsidized, are rising precipitously. Numerous opinions have been offered as to the reason for such defaults: the quality of the housing being insured; the increasing use of Section 223(e) "special risk" programs; the extension of homeownership programs to welfare families; lack of proper administration; the character of the programs themselves; the influence of speculators and "fast buck" artists, and the whole spectrum of urban decay. As yet, however, no comprehensive attempt has been made to elicit information from the class of persons best qualified to speak of reasons for default—the defaulting homeowners themselves. This lack of hard survey data on reasons for default and later movement by the defaulting homeowner lends a flavor of unreality to almost all of the present discussions of this problem.

Recommendation: A research contract should be let by Research and Technology to a qualified survey research firm to trace and interview defaulted homebuyers in a number of large cities to ascertain their reasons for default and their relocation patterns following such default.

2. *Problem:* The present emphasis within the Department, both within the Project Selection system and the "Real City" approach, appears to be geared toward the dispersal of subsidized housing throughout metropolitan areas. Apparently, it is assumed that such dispersal will result in a concomitant dispersal of the poor and the black, thus relieving central city problems and sharing the burdens associated with these groups more evenly. Unfortunately, no data exists which shows that dispersal of such subsidized housing will, even with strong and continued affirmative marketing efforts, result in a subsequent population shift of central city poor and minorities to outlying areas. In fact, indications at the field level show that most occupants of subsidized projects in outlying areas adjacent to large central cities tend to come from the outlying areas rather than the central cities and that the population of such projects tends to reflect the racial mix of the outlying area rather than that of the central city. Such data would tend to call into question the entire basis for a dispersal strategy as well as the process which has characterized such limited "Real City" approaches which have been undertaken, (i.e. Use of "701" planning funds to structure a housing element on an areawide basis leading to the adoption of a "fair share" plan of dispersal of subsidized housing leading to some actual dispersal of such housing as a result of Area and Insuring Office funding decisions in line with the "fair share" formula).

Recommendation: A research contract should be let by Research and Technology to a qualified survey research firm to study the racial and economic characteristics of residents of subsidized housing projects in outlying areas as contrasted to those in central city locations. Particular emphasis should be placed upon ascertaining the previous housing location of such residents. Further, such a study should attempt to ascertain why blacks did *not* move into outlying projects: are the primary reasons lack of information, as the affirmative marketing approach appears to assume, the "chilling" factors of fear and apprehension or an unwillingness to leave established central city neighborhoods. As a counterpart, the study should attempt to ascertain why those black families who did move made this decision.

3. *Problem:* In late 1969, the Department began to undertake a major effort to stimulate the rehabilitation of multifamily, absentee-owned structures in inner-city areas under the Section 236 program. This effort was entitled "Project Rehab" and was meant to be a counterpart of Breakthrough. The structure

of the program was essentially patterned after the earlier BURP experiment in Boston with an effort to avoid the mistakes which had been made in that program. Thus, there was a strong emphasis upon minority sponsorship and entrepreneurship, adequate relocation, recruitment of the work force from the affected neighborhoods, city involvement, and rapid processing of submissions by the field offices. There was almost no attention paid to marketing and managing the structures once they were complete. To a greater or lesser degree, the stated goals of the program are being met. It is, however, highly probable that in many cities most, if not all, of the mortgages under Project Rehab will go into default due to the enormous marketing and management problems associated with rehabilitated apartments in inner-city areas.

Recommendation: To avoid major defaults under Project Rehab, three options appear possible: (1) to substantially increase and concentrate the services available to the residents of Project Rehab buildings through Model Cities or other programs; in short, a service approach; (2) to adopt an approach similar to operating subsidies in low-rent public housing in order to prevent defaults; in short, to add another subsidy to the ones presently in existence, or (3) to utilize housing allowances as a direct subsidy to the tenant. All of these options assume that Project Rehab as presently structured is not a viable program. The Department should examine this assumption promptly and, if it is substantiated, eliminate the program completely or adopt one or a combination of the above options.

4. *Problem:* The FHA single-family programs, the preponderance of which are still unsubsidized, represent a major insurance commitment in most metropolitan areas. Somewhat incredibly, however, data as to the magnitude of this risk is unavailable below the county level; it is impossible to ascertain the amount and location of insured mortgages on a city-by-city basis. In Detroit, for example, the data exists only for Wayne County. Real estimates of potential losses or indices of the success or failure of these insurance programs in the central city are seriously hampered by this data lack.

Recommendation: The Department should immediately begin to gather its data with respect to future cases insured on a city, and possibly neighborhood basis. A major effort should be made to reassemble the presently existing data on the same basis.

5. *Problem:* Communication by the Central Office of policy and procedures suffers, ironically, from the problem of being too great and too small—at the same time. Field offices are flooded with circulars, directives, memoranda and reports which make or alter policy. As a result, it has become almost impossible for field personnel to comprehend what the real areas of emphasis are due to the simple volume of communications being received. On the other hand, there appears to be little real substantive input by the field into major legislative/budget/policy formulation. Review teams from the Central and Regional Office occasionally visit the field but the reviews which they conduct are essentially limited to procedural compliance. Little attempt is made to utilize these reviews to communicate policy determination or to consult in advance of such determinations.

Recommendation: An established, *functioning* system for seeking and utilizing field input into policy formulation should be implemented. A determined effort to reduce the flow of routine issuances should be undertaken with a greater emphasis on utilizing graphic presentations, closed circuit television, regular meetings at the Central Office, and substantive policy papers in order to communicate effectively with the field. An attempt should be made, within the context of the unified issuance system, to indicate matters of highest priority and concern. Perhaps a quarterly issuance system of policy papers, similar to Assistant Secretary Watson's paper on Housing Management, could be utilized by all Assistant Secretaries and the Secretary.

6. *Problem:* Recent Central Office instructions on cost evaluation in multifamily projects have stressed a rigid adherence to the Manual in the cost area. Without attempting a technical essay on the subject, the Manual is (1) not in line in its trade payment approach with the square foot method used by most developers; (2) based on the premise that every item in cost analysis is of equal importance. The latter premise is illogical and produces lengthy and cumbersome cost analysis. The net effect of this approach has been to substantially lengthen feasibility processing. In Detroit, for example, 67 cases are backlogged in the

Cost Section with average production of one case per week. It is very possible that the entire concept of a feasibility letter needs to be redefined.

Recommendation: Reportedly, the Central Office has a computerized cost analysis system under review. This system should be field tested, debugged, and implemented as promptly as possible. The San Francisco system of feasibility analysis should be implemented nationwide if that system has not resulted in a decrease in the quality of projects.

7. *Problem:* Instructions in the HUD Section 235 Handbook, dated September 1971, indicate that valuation processing of applications to be converted to Section 235 financing must take into consideration the possible resale of the property to a "non-assisted" purchaser, and that Section 220 may no longer be used in processing such applications in renewal and code areas. In addition, Section 235 comparables cannot be used in appraising other new homes with Section 235 reservations. The net effect of these two policies has been to virtually eliminate new Section 235 construction in inner and middle-city areas. In light of repeated statements to the effect that the Department is not abandoning inner-city areas and in light of the housing and relocation requirements of the renewal program [105(c) and 105(h)], this policy seems potentially disastrous.

Recommendation: It is recognized that severe problems exist with valuing housing in older, declining areas. Nevertheless, the Department must find some approach which will both protect the purchaser and allow construction to proceed. Merely to bring the program to a standstill is not a solution.

8. *Problem*: Through a cumulation of actions (use of the modified cost approach, implementation of the 30/50 rule, requiring re-appraisals for extensions, use of extensive conditions in commitments), the Department has severely curtailed the operation of speculators in most inner and middle-city areas. Those who continue to operate are, paradoxically, the highest risk operators—those who cannot compete in the outlying areas because of capacity, financial resources or business reputation. It can be validly asked why, under such circumstances, the Department does not take the ultimate step: to insure only homes offered for sale by the owner/occupant.

Recommendation: The Department should determine, finally, what its policy will be with regard to speculators. If it is to drive them out of business, this should be stated and they should not be allowed to utilize the FHA programs.

9. *Problem:* Increasingly over the last two years, the Department has found its programs in severe trouble in some areas with little or no advance warning. Our cumbersome reporting system, the lack of any defined and functioning monitoring system, the difficulty of self-analysis, and the natural tendency to avoid admitting error have all contributed to this situation. Again, it can be validly asked what steps the Department has taken to increase its evaluation and early-warning capacity. The Project Rehab program may be in deep trouble, new Section 236 projects in default are rising, the Model Cities program has expended hundreds of millions of dollars with very mixed results, urban renewal has moved away from clearance to neighborhood residential rehabilitation at the very time when massive clearance may be the only solution in many areas, the water and sewer programs make suburban new construction possible and thus contribute to the drain of the middle-class from the cities, operating subsidies for low-rent public housing are so limited that the bankruptcy of a number of large city LHAs seems assured—but almost no evaluation of programs or of field performance appears to be being performed at either the Regional or Central Office level. In addition, field offices themselves are probably not utilizing information which is available to them locally in order to perform meaningful analysis of programs and problems. In part this may stem from confusion over the responsibility for performing evaluation and in part from the pressure of ongoing business; neither of these reasons is, however, any excuse for the lack of preparedness on the field level to anticipate upcoming problems. Even more disturbing, no *system*, on the Central Office or Regional Office level, for ongoing evaluation or monitoring appears to be in place or even contemplated. Further, the Department has established no clear criteria or even general guidelines upon which to judge the success or failure of its programs or operations. Without such criteria, no evaluation system can operate and the Departmental "goals" become a mockery. Far from learning from our mistakes, we appear to be resigned to repeating them.

Recommendation: The Department should establish a measurement system, defining as specifically as possible its criteria as to program and operational success. Around such criteria, an on-going evaluation system should be established and given first

10. *Problem:* Field offices have for years raised the problem of the ever-increasing volume of reports required by the Central and Regional Offices. Often this complaint is brushed aside as being unimportant or engendered by a desire to avoid work. Little attention has been given to cutting down on the staggering burden of reporting requirements or to whether the reports which are required are sensible or useful. (An exception to this pattern is the Community Development area where a substantial reduction in reports has been achieved.) Generally, the response has been to indicate that the matter is under study or that the field should list the reports which are particularly burdensome. (This latter response is particularly ludicrous given the fact that the field does not use the reports and has no knowledge of why they are required or to what purpose they are put.) Referring back to the evaluation problem outlined above, it is quite clear that despite the volume of reports and statistics that are transmitted from the field, this information has not been useful in anticipating major problems with which the Department has later been confronted.

Recommendation: The Department should, in fact and not in rhetoric, initiate an immediate and comprehensive study of each and every report presently in existence. Such a study should be directed to answering three questions: (1) Is the report necessary at all?; (2) Is the quantity of data required necessary and will it be used?, and (3) Is the report necessary on as frequent a basis as is presently required? This study should be conducted on the Central Office level by Central Office personnel with a top-level representative of each Assistant Secretary required to defend each report in light of these questions.

11. *Problem*: At the field level, meaningful coordination and inter-action with other Federal departments is almost non-existent. The Federal Executive Board is of little real assistance given the character of its membership and its perceived mission. The Region Council has, frankly, been no more useful. The RICC for Model Cities appears to have virtually disappeared. We continually reiterate that the problems of the cities cannot be solved by housing or community development programs alone, but no effective mechanism exists at the field level to marshall the resources of the Federal government to deal with these problems or anything approaching a systematic, coordinated basis. Shortly, I suspect, our rhetoric will begin to catch up with us on this point.

Recommendation: Consideration should be given to the creation of Federal urban task forces for major cities with high-level personnel assigned to such bodies with sufficient authority to implement change. Such task forces should meet regularly, should be staffed, and should be accountable for the achievement of a limited number of defined goals. Since several of the urban agencies, HEW and Department of Labor notably, act almost exclusively through state agencies, state personnel should be included on such task forces.

12. *Problem:* The Department has, nationwide, been subjected to intensive press attention and criticism concerning its programs and operations. Part of this criticism is unavoidable given the nature of the problems and programs with which we deal, part could have been avoided by proper administration at the field level, and part is merely sensation-mongering. However, the Department's reaction has been haphazard and generally defensive in nature. In particular, the most positive aspects of our actions, our funding decisions, have not been adequately communicated to the media and the public. The system of congressional announcement/Washington press release virtually guarantees that this will be the case.

Recommendation: A coordinated system of announcement of funding decisions with local press releases to local media immediately following congressional announcement, should be implemented.

William C. Whitbeck,
Area Director, Detroit.

HOUSING SUBSIDIES AND HOUSING POLICIES

TUESDAY, DECEMBER 5, 1972

Congress of the United States,
Subcommittee on Priorities and
Economy in Government of the
Joint Economic Committee,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room G–308, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative Blackburn.

Also present: John R. Stark, executive director; Loughlin F. McHugh, senior economist; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

Opening Statement of Chairman Proxmire

Chairman Proxmire. Are Mr. Downs, Mr. Aaron, and Mr. Emmer here? Will all of you gentlemen come to the front? Mayor Gribb's plane was delayed so we are going to start off with the panel. Mayor Gribbs will be in in a half hour or so, I understand, and we can start off with you gentlemen, Mr. Emmer, Mr. Downs in the middle, and Mr. Aaron on the left.

Today the subcommittee continues its hearings on Federal housing programs in an effort to assess their faults and benefits. In the area of housing subsidies we intend to determine to what extent program deficiencies are the result of poor management, a matter that could be corrected through better leadership at HUD, or to what extent failures are the result of bad legislation and require congressional action.

Yesterday we heard a great deal about the weaknesses in management that have led to a high incidence of program failures in both subsidized and nonsubsidized housing. The General Accounting Office and a distinguished panel told the subcommittee that, among other things, HUD failed to get the subsidized units to the families most in need; it had failed to inspect homes and prevent shoddy construction; it had failed to provide counseling to families inexperienced in homeownership; it had failed to establish any system to analyze and prevent defaults; it had failed to weed out those families incapable of meeting the responsibilities of homeownership; it had dismally repeatedly failed to train its personnel properly; it had shockingly failed to monitor the performance of its personnel; and it had failed to protect the Government against excessive land costs and fees.

89-901—73——18

I think we can anticipate hearing more about these managerial problems today from Mayor Roman Gribbs of Detroit and Mr. Philip Emmer, a developer of low-income housing. I notice in his prepared statement evaluating HUD management, for example, Mr. Emmer says, and I quote: "Just put me down for about 2 hours of examples of things that have gone wrong."

Yesterday's hearings also provided several important ideas on how to improve the economic design of housing subsidies. The General Accounting Office recommended that the Federal Government switch to direct loans for the major housing subsidies because it could save the Government between $2.1 and $5.4 billion over the 5-year lifetime of these programs. GAO also suggested that we restructure the tax incentives for the 236 rental subsidy since the present incentives do not encourage careful long-term management of these units.

Today we wish to explore the economic and social questions surrounding existing housing subsidies and proposed alternatives of how significant are the conflicts between the objectives of increasing housing production to provide more jobs and more homes as one objective and providing income maintenance to low-income families as another, and stemming the decay of our inner cities as still another.

How equitable is the distribution of subsidy benefits among various income groups and among producers and consumers? How effective have housing production subsidies been in achieving a net increase in total housing starts? We will also want to look at the interrelationships of housing subsidies and the economic and social viability of our urban areas.

In particular, I hope that we can focus a good deal on the advantages and disadvantages of the housing allowance alternative. In yesterday's hearings several members of a panel were critical. I think I would have to construe their position as being opposed, to the housing allowance alternative because they say it would depress housing production, and we need more housing construction, in their view, and we need it, we are going to need it for some time.

I notice Mr. Aaron's paper, however, argues that it is more flexible, more equitable and at least to some extent more efficient than existing programs.

To speak to us about the effectiveness of the present housing programs we have the mayor of one of our larger cities coming in after you gentlemen are through. We also, and we now, have a panel of three authorities who have recently been engaged in extensive analysis of housing programs. We are very proud of this panel. We think you gentlemen are all very well equipped and, I must say, your statements which you filed with the committee impressed me very much. These are all most constructive and useful statements.

Henry Aaron, an economist from the Brookings Institution and the University of Maryland, who is the author of a recently published book on housing, "Shelter and Subsidies"; Anthony Downs, vice president of the Real Estate Research Corp., and director of a recently released study of "Federal Housing Studies: How Are They Working?"; and Philip Emmer, a successful developer of subsidized low- and moderate-income housing, who has run into a lot of problems over the years, and undoubtedly will give us a very pragmatic and useful insight.

Mr. Aaron, why don't you start off. We have a rule with which you are familiar, I think, of 10 minutes——

Mr. AARON. Yes, sir.

Chairman PROXMIRE (continuing). Of your opening statement, and we will ring a buzzer toward the end and then you can summarize or give us your recommendations and we will move on to Mr. Downs.

STATEMENT OF HENRY AARON, SENIOR FELLOW, THE BROOKINGS INSTITUTION

Mr. AARON. I have submitted a prepared statement which I hope can be placed into the record.

Chairman PROXMIRE. Yes, the entire prepared statements of each of you gentlemen will be printed in full in the record in the event you abbreviate your prepared statement in any way. Your prepared statements are very helpful.

Mr. AARON. At this point I would like briefly to summarize the main conclusions of that prepared statement. I shall spend the bulk of my 10 minutes on housing allowances.

The first conclusion is that the existing programs of housing assistance, principally public housing, sections 235 and 236 of the National Housing Act, and rent supplements have begun since 1969 to add significantly to the stock of standard housing available to low-income families. They have been largely successful in their stated goals of building standard housing for low- to lower-middle-income families.

The scandals which have surrounded them are real and deserve careful scrutiny but, in my opinion, they do not go to the basic issues concerning the desirability of this form of housing assistance.

My second conclusion is that by far the largest housing subsidies in the present system of income tax preferences to homeowners that were worth about $7 billion in 1966 and nearly $10 billion in 1970. These tax concessions accrue primarily to families in the upper half of the income distribution, negligibly to families in the lower half of the income distribution. The distributional pattern, in my judgment, is inequitable, and these subsidies inefficiently promote the only objective that I have heard advanced on their behalf, the promotion of homeownership. If Congress were confronted with the option of enacting an expenditure program identical to current tax benefit to homeowners, I doubt whether a single Representative or Senator could be found to support so bizarre a scheme.

Third, the housing problem of low-income families is a rather peculiar melange of high housing cost and inadequate quality of structures; but it is predominantly a problem of bad neighborhoods and inadequate urban services. For that reason any policy that deals only with structures and ignores the problems of neighborhood decay and inadequate urban services is bound to fail.

Fourth, subsidies tied to new construction are inherently inefficient in the sense that they use more real resources than necessary to raise housing standards to accepted levels. They are certain to create inequities and arouse political opposition that will lead to their curtailment.

Fifth, neither the real shortcomings of existing programs nor the political furor now occurring around them justify scrapping them without an adequate alternative. In particular, replacement of exist-

ing programs by block grants for housing to State, metropolitan, or regional authorities surrenders most Federal leverage in the assertion of a national interest in housing. The administration of most programs already is effectively decentralized.

Sixth, other means of assisting low-income households should be sought that are free of the shortcomings of existing programs. A promising approach, housing allowances paid to families on the basis of their economic circumstances, appears to have major advantages. Nevertheless, theoretical objections have been raised of sufficient seriousness to make questionable the abrupt introduction of a universal allowance system. These objections do not apply, in my opinion, to more limited programs or to the gradual introduction of a universal system.

Now, I would like to go into more detail into the housing allowance scheme itself.

Chairman PROXMIRE. What page are you on?

Mr. AARON. I am excerpting from the prepared statement.

Housing allowances can be used for two quite distinct purposes. First, they can be combined with a broad system of income maintenance. The major source of cost of living differentials throughout the United States is variation in housing costs. Housing allowances would, therefore, be a logical way to build some regional differentiation into a broad income maintenance system without varying the basic support level. Second, housing allowances may be used to supplement or replace some or all increments to unit-specific or construction-oriented housing subsidies. The following remarks refer to this second kind of housing allowance rather than the first.

Housing allowances come in different shapes and sizes. They can be related to family income or to housing expenditures. In either case, family net worth might be taken into account in determining eligibility.

As I see it, the chief advantages of housing allowances are the following: First, allowances would enable the recipient household to choose among all available standard units. The key feature is that the recipient household would be free to use the subsidy on any unit of its choice and to carry the subsidy with it whenever it wished to move. The recipient might use the subsidy to choose to buy better houses or better neighborhoods or better municipal services such as schools; or they might choose to live where they had a better chance of getting jobs.

Second, allowances could be provided equitably on the basis of income or housing expenditure, thus avoiding two inequities that arise under current programs. One is that the linkage of subsidies to new construction severely constricts the number of subsidized units available. As a result, some families receive quite large subsidies while other, even poorer, families are denied them. Another is that existing programs cause leapfrogging, the situation when one household is provided better housing than another wealthier family can afford to buy without a subsidy. The problem of leapfrogging is going to be politically a rather troublesome one.

Third, allowances would remove the Government from direct involvement in the issue of site selection. The issue of residential choice

would be left to individual households. To make certain that the resulting choices are genuinely free and well-informed it would be vital that the Federal Government provide abundant counseling and vacancy information services and that open housing legislation be enforced with uncustomary strictness.

The cost of a housing allowance depends sensitively on various aspects of the program. Eligibility could be limited to certain groups, benefits could be set at different levels, the rate at which benefits are reduced as income or housing outlays rise could be varied. Net worth can be used in determining eligibility.

I have estimated in the JFC report that a universal housing allowance of the income-gap variety based on family income, with an asset test, would have cost from $4.9 to $6.2 billion in 1967, depending on the impact of the allowance on housing costs, a point to which I will return.

In the design of any housing allowance a number of important issues would have to be resolved. First, it would be necessary to decide how closely the Government would supervise expenditures by recipients to assure that housing allowances resulted in higher expenditures. On one extreme, the Government might avoid all supervision whatsoever. In that case, the housing allowance in fact would not be a housing allowance but simply an unrestricted cash grant. On the other extreme, the Government might closely supervise expenditures to assure that the allowance is additive to housing outlays.

The second issue is that program designers would have to decide what measures should be taken to deal with the most common and most serious objection to housing allowances—that landlords would respond to them by jacking up rents, leading to higher income for property owners, but not to better housing. This objection rests on presumed answers to the two crucial questions about the operation of housing markets.

How will recipients respond to allowances? Will they stay put in existing residences? Will they seek better housing, but within present narrowly defined neighborhoods? Will they seek better housing outside present neighborhoods? In fact, there is not very much evidence on exactly what recipients would do, and in all likelihood the behavior would vary widely depending on the characteristics of the household and of the neighborhoods in which they reside.

How will landlords respond to increased housing demand? Are there monopolists capable of extracting much or most of allowances in higher rents? Or will they, like other competitive producers, respond to higher demand by increasing supply? While evidence on the response of property owners to a housing allowance is unavailable, a considerable amount of information suggests that property owners would respond by increasing supply, particularly if guided by the threat of vacancies, and that they would respond by raising rents in order to cover improvements and better maintenance that tenants would be in a position to demand.

A third question concerns the manner in which housing allowances should be introduced. A generous universal system of allowances could be introduced simultaneously throughout the Nation, largely replacing increments to existing programs. On the other hand, a system of allow-

ances could be introduced gradually as a supplement to, or a partial replacement of, increments in existing subsidy programs. Gradual introduction could be managed in various ways. Housing allowances could be paid only to certain groups, such as the aged, or they could be introduced only in certain areas, or they could be introduced subject to budget limitations so that within each housing market not all eligible families received the allowances at the outset.

In this connection, I would like to add that, in my opinion, the housing allowance for the aged would be far superior to property tax relief for the aged which has been discussed by President Nixon and others.

The property tax proposal has been based on evidence that many aged pay property taxes equal to a large fraction of income. The evidence used to establish this hardship is questionable, but even if such hardships are as serious as alleged, and if property taxes are treated as an element of housing cost, there is no reason to single out this element of housing cost for subsidy. It would be far more equitable to provide housing allowances so that the total cost of decent housing for the aged did not claim an excessive share of income.

Getting back to the housing allowances, itself, however, limitations on the suddenness with which allowances were introduced would minimize the chance that a large increase in demand would disrupt housing markets or drive up prices even temporarily.

Furthermore, continued construction under existing subsidy programs could be used to solve any remaining transitional problems. I have about one page more.

Chairman PROXMIRE. All right, go ahead. We had two bells. The second one was apparently pilfered by some witness who was unhappy about it. [Laughter.]

Mr. AARON. A fourth question concerns the measures that should accompany allowance payments to promote improved housing standards. Such measures might range from serious efforts at code enforcement to specific evaluation and approval of each unit occupied by an allowance recipient.

In closing, I would like to mention the housing allowance experiments now being designed at the Department of Housing and Urban Development. One experiment will investigate the response by households to a variety of housing allowance formulas. That experiment will be undertaken in two metropolitan areas, and I understand payments are scheduled to begin shortly.

The second experiment is far more difficult and important. It will saturate a few metropolitan areas with a basic housing allowance in order to measure precisely how much the housing allowances cause the supply of housing services to increase and how much they will cause the cost of housing to increase. In fact, this experiment is being carried out on grounds most favorable to the critics of housing allowances because it involves a large-scale simultaneous introduction within an entire housing market.

I do not believe that it is either necessary or desirable that implementation of a modest system of housing allowances await completion of these experiments, however. As a practical matter, a universal, full-scale allowance is unlikely to be proposed because of budget limitations. There is no evidence that the gradual introduction of a partial

allowance program, in conjunction with existing, construction-oriented programs, would disrupt local housing markets or drive up prices. The inherent difficulties of any system of subsidies tied to particular units, and especially to newly constructed units, suggest that allowances be introduced. These difficulties do not indicate that existing programs should be scrapped, certainly not until a generous national system of allowances has become operational. The present system of housing assistance is the only device now in operation to help improve housing and residential choice for low-income families. The blatant abuses of these programs can be removed by improved administration. The goal of better housing is certainly worth the cost of reform.

Thank you.

(The prepared statement of Mr. Aaron follows:)

Prepared Statement of Henry Aaron*

Federal Housing Subsidies: History, Problems, and Alternatives

Federal housing policies have been much in the news. Allegations of scandals in the administration of various programs of the Federal Housing Administration have received widespread coverage in the press and provoked concern within Congress. The feeling is abroad that existing federal housing programs have failed and require thorough overhauling.

In my opinion the existing federal housing policies do deserve serious reexamination, but not because they have failed and not primarily because of reported scandals. The scandals and deficiencies in management need to be studied and dealt with. But existing programs of housing subsidies deserve to be reexamined principally for structural shortcomings that housing analysts, federal officials, and others have worried about for some time. In support of this contention, this statement contains three main parts. The first traces the development of federal housing policies through three main periods. The second describes the nature of the housing problem that exists today and will exist in the immediate future. The third examines the suitability of existing programs for dealing with the housing problem and urges that serious consideration be given to a new form of housing assistance, and allowance for housing to low income families based on income or housing expenditures.

The major conclusions of the paper are the following:

(1) Major existing programs of housing assistance—low rent public housing, homeownership and rental assistance (sections 235 and 236 of the National Housing Act), and rent supplements—have begun since 1969 to add significantly to the stock of standard housing available to low income households.

(2) The housing problem of low income families is a peculiar melange of high housing outlays and inadequate quality of structures; but it is predominantly a problem of bad neighborhoods and inadequate urban services. Any policy that deals only with structures and ignores the problems of neighborhood decay and inadequate urban services is bound to fail.

(3) Subsidies tied to new construction are inherently inefficient in the sense that they use more real resources than necessary to raise housing standards to accepted levels. They are certain to create inequities and arouse political opposition that will lead to their curtailment.

(4) Other means of assisting low income households should be sought that are free of these shortcomings. One such approach, housing allowances paid to families on the basis of their economic circumstances, appears to have major advantages. Nevertheless, theoretical objections have been raised of sufficient seriousness to warrant careful study through pilot programs or experimentation. A universal program should not be implemented abruptly.

(5) Neither the real shortcomings of existing programs nor the political furor now occurring around them justify scrapping them without an adequate alternative. In particular, replacement of existing programs by block grants for hous-

*The views presented in this statement are those of the author and not necessarily those of the officers, trustees, or other staff members of the Brookings Institution.

ing to state, metropolitan, or regional housing authorities would constitute an abdication of federal efforts to solve the housing problem. Further decentralization of the administration of existing programs could only occur if the federal government renounced a national interest in housing, since the administration of most programs already is effectively decentralized.

I.

Federal housing policies have passed through three rather distinct phases. The first was marked by the creation of major new institutions to improve the operation of the housing market. This phase began during the Great Depression and ended in about 1950. During this period the Federal Housing Administration (FHA), the Veterans' Administration (VA), the Federal National Mortgage Association (FNMA), and the Federal Home Loan Banks (FHLBs) were all created. The basic programs of FHA mortgage insurance and VA loan guarantees, still the largest programs of the administering agencies, were begun, and operating procedures were established. These programs facilitated a revolution in credit practices of mortgage lenders that made home ownership possible for millions of families who would have had to defer or forgo ownership under credit practices of an earlier age. Both FNMA and FHLB improved and, at times, may have increased, the flow of mortgage credit.

During this era the largest and least defensible federal housing policy achieved dominance. Income tax benefits to homeowners had been present in the internal revenue code for three decades in the form of the exclusion of net imputed rent and the deductibility of mortgage interest and property taxes under the personal income tax. But they had little quantitative significance as long as marginal tax rates were low. Most families paid no income tax until 1940 and the majority of those subject to tax faced rates of no more than 3.6 percent. The jump in personal income tax rates to help finance the war and the continuation of high rates even after the war drastically increased the importance of these tax preferences. *By 1966 the annual flow of subsidies accruing to homeowners totalled $7 billion; by 1971 the flow had swelled to nearly $10 billion.* These income tax concessions accrue primarily to upper income households, negligibly to middle and moderate income families and not at all to low income families. This distributional pattern is inequitable, and inefficiently promotes the only objective of these tax concessions commonly advanced, the promotion of homeownership. If Congress were confronted with the option of enacting an expenditure program with identical effects, it is doubtful that a single Representative or Senator could be found to support so bizarre a scheme.

The oldest of housing subsidies to low income families, the low rent public housing program, was also born during this period. But the scope of the assistance was modest and many units were built, not for the poor, but for defense workers.

In short, the first phase of federal housing policies was marked by the creation of major new instituitons that have survived to the present. The major housing subsidies grew up as a byproduct of increasing use of the personal income tax; they accrue overwhelmingly to families with incomes of $10,000 per year or more. Subsidies for low income families were confined to the small and slowly growing low rent public housing program.

The second phase of federal housing policies occurred against the background of massive suburbanization of metropolitan areas and an explosion of home ownership. Both were assisted by the easier credit conditions that the institutions created in phase one made possible and by the massive tax incentives to home ownership.

The second phase of federal housing policies began with the decision of President Eisenhower, ratified by congressional inaction, not to construct the 810,000 low rent public housing units authorized by the Housing Act of 1949. This decision began a period, lasting until 1968, during which there was much talk, but little action, about housing assistance at the federal level. The major institutions, begun during the first phase, continued to perform more or less as their creators intended. Tax preferences for homeowners were left substantially intact. Congress enacted a few new subsidy programs, but without exception these were small. The most talked about were direct loans at subsidized interest rates by FHA and the Farmers Home Administration. But total

subsidized housing starts never reached 100,000 units per year from 1950 to 1967; they totalled only 856,000 units over the 18-year period or only 3 percent of all starts.

Phase three of federal housing policies began in 1968. The Housing and Urban Development Act of 1968 declared that the construction or rehabilitation of 26 million housing units over the decade 1969–1978 was a national goal, 6 million with federal assistance and 20 million without federal assistance. It created two large new programs to assist lower-middle and low income families to buy or to rent adequate housing (home ownership and rental assistance under sections 235 and 236 of the National Housing Act). In short, this bill called for federal housing assistance in the construction or rehabilitation of 600,000 units per year, more than 12 times the average rate in the period 1950–67.

The enactment of this goal and the programs to implement it resulted from the historical coincidence of two largely unrelated housing problems. First, a much increased rate of new family formation was projected. This increase followed two years during which tight money had inhibited residential construction. As a result many feared that a general housing shortage might occur. Second, the growing awareness of poverty and urban decay made the orientation of federal housing policies largely to middle and upper income and suburban families seem peculiarly anachronistic.

Actual performance since 1968 has fallen somewhat short of the housing goal, but has been spectacular by historical standards. Total starts have averaged over 2 million units per year since 1969, a sharp increase over the performance of preceding years due largely to the increase in subsidized starts; the number of subsidized starts exceeded 1 million in the three year period 1969–71 and promises to total 1.5 million late this year or early next year. There is some evidence that total housing starts have not been affected by the sharp increase in assisted starts and that assisted starts have largely replaced unassisted starts.[1]

As the flow of housing assistance to low and moderate income families swelled, serious administrative and political difficulties appeared. First, investigative reporting turned up instances of corruption, bad administration, or poor judgment in several cities. Only some of these allegations involved programs of housing assistance; many involved unsubsidized programs that operated in high risk areas. Although the dubious or dishonest procedures occurred in only a few communities, the reports triggered concern about the entire system of federal housing assistance. The malpractices of some raised doubts over the soundness of the entire program.

This reaction, in my opinion, has been misdirected and out of proportion. The vast majority of rental assistance (section 236) housing—over 90 percent as reported by Anthony Downs—is not in financial difficulty. A small minority of units under the homeownership assistance program (section 235) is in default.

The reaction to the press reports of corruption reflects one sound perception and one false expectation. The sound perception is that the reported incidents are scandalous and must be prevented from recurring. The false expectation was that programs to subsidize housing for the poor or to assist construction in high risk areas could operate as do other programs of the Federal Housing Administration. Designers of these programs, administrative officials, and Congress should have anticipated that default rates would be higher and that low income families would make more mistakes than are customary under unsubsidized, low-risk programs. Workloads for FHA offices should have been reduced; in fact, they have been increased. Generous counselling services should have been mandatory for homebuyers; in fact, they are meager and spotty. Rigorous cost control on new construction should have been instituted to replace the market tests absent from these programs; in fact, they were loose and easily circumvented.

Even if the housing assistance programs had operated without a hitch, they would have been surrounded by political controversy for at least three reasons. The first is the issue of site selection. When assisted housing construction was meagre, the problem was not serious. Public housing was placed in large cities or in small towns and reinforced already existing economic and racial living patterns. When the flow of assisted construction rose to levels prevalent in recent years—nearly one-fourth of all conventional starts in 1970 and 1971—this practice was no longer feasible. If massive dislocations and wholesale destruction of

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[1] See Craig Swan, "Housing Markets: An Aggressive View," Working Paper No. 40, Federal Home Loan Bank Board, November 1972.

sound units was to be avoided, much assisted housing had to be built outside large cities on vacant land. But if the new housing was to be built where the poor lived, it had to be built near large cities. In other words, assisted housing had to be built in the suburbs. Given the widespread taste for economic exclusivity and the power of racial discrimination, this necessity led logically and inevitably to bitter protests against the construction of subsidized housing—in other words, to the Forest Hills-Black Jack problem. This problem is unavoidable within any program that permits the poor and minorities to live in significant concentrations in previously middle and upper income neighborhoods. But existing programs maximize the political conflict surrounding site selection. Most assistance under existing housing programs is channeled through new construction, usually in projects consisting of many single- or multi-family dwellings. These projects invariably require some local action or cooperation. They constitute clear and obvious objects on which local residents or interest groups can focus hostility to or distaste for the poor in general or minorities in particular.

A second source of controversy, leapfrogging, is certain to become more serious in the future than it is today. By leapfrogging, I mean the provision directly or through federal subsidy of better housing to one family than other, richer families, can afford to buy without subsidy. In less blatant form, leapfrogging occurs when not enough subsidized housing is available to accommodate all families judged equally eligible on the basis of income. Leapfrogging is a problem because it is unjust and because it is recognized as unjust. Leapfrogging creates its own resentment and it aggravates the resentment caused when an unwilling community is forced to accept assisted housing. Thus, leapfrogging endangers the entire effort to improve housing for low income families.

This problem also is unavoidable within any program heavily dependent on new construction. New construction must meet essentially middle class building codes. If income limits for eligibility are set so that all households are eligible who cannot afford similar housing without subsidy, a large proportion—as much as 25–30 percent of all households—will be eligible on the basis of income. The national housing goal projects federally assisted housing at the end of the goal decade at about 7 million units, less than 10 percent of the total housing stock. Even if the present proportion of assisted starts were continued in perpetuity, the problem of leapfrogging would not vanish for a number of decades. Of perhaps greater relevance is the fact that leapfrogging will grow continually more pervasive during the housing goal decade. A trickle of letters to congressmen from constituents irate because neighbors no poorer than they get housing subsidies that they don't receive has begun to appear. It is certain to increase.

A third problem, that has troubled some housing experts, is the mounting evidence that the policy of linking housing subsidies to new construction is needlessly costly and relatively ineffective in raising living standards. They are needlessly costly because newly constructed housing tends to be better and to cost more than existing standard housing. The estimated cost of housing in the Bureau of Labor Statistics' low cost budget is about two-thirds of the total annual cost of new subsidized housing (including costs to both the government and the tenant). Low income families receive not just standard housing but something better, as far as structural quality is concerned. As far as neighborhood amenities are concerned, I shall argue below, they receive something much worse. (It is rather as if the government had decided to assure adequate transportation to poor people by buying new Pontiacs for them, instead of used Chevrolets, but then required that the new cars be driven only on side streets.)

But even these expenditures to subsidize new units are inefficient devices for the improvement of living standards of their recipients. They deny subsidy recipients most discretion over the combination of residential services to be consumed. The small number of subsidized units relative to the eligible population means that new entrants face a take-it-or-leave-it choice on particular units. The family that would prefer to spend its subsidy to buy less house, but better schools, or a lower crime rate, or better access to jobs, does not have that choice.

Even if this problem is minor for new entrants, it is bound to grow more serious for families as their tenure in subsidized housing increases. Workers, especially the poor, change jobs frequently; children are born; others mature and leave home; suitable neighborhoods become unsuitable. The occupant of assisted housing might wish to move if assured that assistance moved with him, but since current subsidies are tied to particular units and these are in short supply, he may choose to stay put, until the inconvenience of the unit exceeds

the value of the subsidy. In this respect, current housing assistance programs resemble rent control which provides relief from housing costs but becomes inefficient as time passes—housing needs change, but families cling to controlled units.

II.

The proper design of federal housing policies should emerge from an accurate perception of the contemporary housing problem. Unfortunately, inaccurate perceptions are widespread. Among these misperceptions are that the quality of housing structures is growing worse, at least in large urban areas of the United States. As always, some units grow old and deteriorate, remain vacant for increasing periods, and, eventually, are demolished. By almost every objective index of quality, however, housing conditions are continually improving. Overcrowding has continuously declined for at least three decades and the availability of every measured facility has increased. Large numbers of poor quality units persist, but their number has diminished steadily.

Another misperception is that low income families on the average spend a larger fraction of their incomes on housing than do high income families. It is true that families whose incomes are temporarily depressed spend especially large fractions of income on housing, but they also spend especially large fractions of their incomes on other goods as well. Small families spend more on housing than large families, young than old. In fact, housing expenditures represent a roughly constant fraction of total expenditures if family size and age are held constant.

The basic housing problem of low income families is not that they spend a larger (or smaller) fraction of income on housing, on the average, than do higher income families, but that they cannot spend enough to obtain the decent home and suitable environment promised nearly a quarter century ago in the Housing Act of 1949. Because the number of families whose incomes fall below the level at which they can afford various housing facilities is continuously falling, the proportion of families lacking these facilities is continuously falling. I am prepared to supply documentation for each of these assertions if the Committee desires.

What then are the dimensions of the housing problem? It has two quite distinct elements.

First, despite the steady growth in incomes, the pace of which has far exceeded the increase in housing costs, many families remain too poor to buy housing most of us consider adequate. Per capita incomes have doubled since 1959; rental prices rose 32 percent over the same period.

Second, a large part of the housing problem concerns a process of social and economic interaction no one fully understands. Housing structures exist in a particular neighborhood. Residents of a particular housing unit get not only the services of that structure, but also a certain set of neighbors, local schools, a crime rate, a transportation system, nearby shopping, and a host of other locationally fixed services. The owner of a particular housing unit possesses an asset whose value depends partly on what his tenants are willing and able to pay and this in turn depends on the entire range of complementary residential services as well as the characteristics of his housing unit), partly on maintenance costs (which depend not only on the behavior of the tenant, but also on his neighbors), and partly on various other factors such as taxes. The result is that a good tenant in a bad neighborhood may get a decent housing unit but have serious housing problem because his neighborhood is dirty, his wife is afraid to walk to the store, his children attend deplorable schools, or the risk of crime is high. Moreover, he may pay high rents to a landlord who tries honestly, but with little success, to maintain housing quality in the face of vandalism, rising taxes, and generally rising maintenance costs. Both tenant and landlord may be victims of forces they are powerless to resist; the only salvation is to move, but the tenants cannot afford to do so and buildings are fixed.

Although this picture of the housing problem of poor urban families conflicts with the conventional view, it has been supported by the major studies that have carefully investigated housing in the inner city.[3] It suggests that the housing

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[3] See Michael A. Stegman, *Housing Investment in the Inner City: The Dynamics of Decline*, M.I.T. Press, 1972; George Sternlieb, *The Tenement Landlord*, New Brunswick Urban Studies Center, 1966; and George Sternlieb, Robert W. Burchell, and James W. Hughes, *Inner City Markets: Housing Costs and Housing Restraints, Newark, New Jersey*, New Brunswick Center for Urban Social Science Research, 1970.

problem of poor urban dwellers is far more complicated than bad structures and that building more structures alone will not solve the problem. Concentrations of the poor or of other social problems aggravate the problem of bad housing. Whether these concentrations exist in central cities, urban fringes, or suburbs is secondary. It is the size and homogeneity of the concentrations that is primary.

The present set of housing subsidy programs can be used to reduce concentration, although not all supporters of existing programs advocate that they be used for this purpose. As I tried to suggest in the preceding section, resistance by local communities to the dispersal of low income households is powerful. Courageous, inspired, or (some would say) foolhardy national leadership could fight out each case and use existing programs to reduce economic and racial concentration. If one could be confident that such leadership would be exercised, one might be more willing to suffer the other shortcomings of existing programs. I suspect, however, that the result of Forrest Hills, Black Jack, and other less publicized local protests against accepting assisted housing will be that assisted housing continues to be placed predominenty in central cities, in poor quality suburban land, or in those older suburbs already infected by the processes of decay.

III.

Current housing programs tie subsidies to particular, usually new, units. Many of the problems with these programs derive from this feature. Accordingly, a growing number of housing analysts have advocated that housing subsidies be awarded to families for the rent or purchase of any unit. A wide variety of such plans have been advanced under the name "housing allowances." This section will describe some of these plans, indicate the crucial issues in designing housing allowances, and review the arguments for and against them.

Housing allowances may be used for two quite distinct purposes. First, they may be used in combination with a broad system of income maintenance. The major source of cost of living differentials throughout the United States is variation in housing costs. Housing allowances would be a logical way to build some regional differentiation into a broad income maintenance system without varying the basic support level. Second, housing allowances may be used to supplement or replace some or all unit-specific or construction-oriented housing subsidies. The following discussion refers to housing allowances of the second kind.

The chief advantages of housing allowances are:

- Allowances increase the flow of resources available for the maintenance and improvement of existing units. Deficient housing typically was not built that way, but deteriorated because the cost of sustaining its quality exceeded what its occupants could afford to pay. Allowances would contribute to improved housing conditions, not by subsidizing a trickle of new high quality units, but by helping to arrest deterioration in the mass of standard units occupied by potential beneficiaries.
- Allowances would enable recipient households to choose among all available standard units. In seeking housing recipients would be cash customers looking for the best deal, rather than households specially designated by their residence as subsidy recipients. The key feature is that the recipient household would be free to use the subsidy on any unit of its choice and to carry the subsidy with it whenever it wished to move. Recipients might use the subsidy to choose to buy better houses, better neighbors, better municipal services such as schools, or better location for employment.
- Allowances could be provided equitably on the basis of income or housing expenditure to avoid the problem of leapfrogging. While a gradual introduction of allowances might be desirable to avoid dislocations, this period is far short of the decades that would be necessary if subsidies were confined to newly constructed units.
- Allowances would remove the government from direct involvement in the issue of site selection. The issue of residential choice would be left to individual households. To make certain that the resulting choices are genuinely free and well informed it would be vital that the federal government provide abundant counselling and vacancy information services and that open housing legislation be enforced strictly.

Housing allowances come in various shapes and sizes. They may be related to family income (an income-gap allowance) or to housing expenditure (a percentage-of-rent allowance). In either case, family net worth might be taken

into account in determining eligibility. The typical income-gap allowance presumes that the household will spend a certain fraction of income on housing. If the cost of "basic" housing exceeds the amount the household is expected to spend, the household receives an allowance equal to the difference. The typical percentage-of-rent allowance would provide each household with a grant equal to a fraction of gross rent (or housing expenses for homeowners); this fraction could be related either to income or to gross rent.

The cost of a housing allowance depends sensitively on various aspects of the program. First, eligibility may be limited to certain groups. For various reasons (none of which I find compelling), single persons, childless couples, or homeowners might be excluded. Second, benefits may be set at various levels. The higher the benefits for families with no income, the greater the cost. The rate at which benefits are reduced as income or housing outlays rise is an even more important determinant of cost, however. Moreover, this implicit tax will interact with those contained in other programs to provide cash support and to subsidize other kinds of consumption. The resulting grant system must be designed as a whole if work incentives for the poor are to exist.[3] The Joint Economic Committee's Subcommittee on Fiscal Policy is performing a major national service by gathering, publishing, and studying heretofore unavailable information on the interaction of various forms of cash and in-kind assistance. Third, net worth can be used in determining eligibility. The purpose of such a test would be to exclude those with considerable assets but little income. On economic grounds, net worth clearly should count in the determination of eligibility; the administrative and political costs of such a test, particularly one which counts all assets, may be substantial. The best procedure probably would be to exclude some amount of net worth, say $5,000 to $10,000 from the determination of eligibility or the size of the allowance.

I have estimated that a modest universal housing allowance of the income-gap variety, with an asset test, would have cost from $4.9 to $6.2 billion in 1967, depending on the impact of the allowance on housing costs.[4]

In the design of any housing allowance a number of important issues would have to be resolved. First, it would be necessary to decide how closely the government would supervise expenditures by recipients to assure that housing allowances resulted in higher expenditures. On one extreme, the government might avoid all supervision. In that case, the housing allowance in fact would be an unrestricted cash grant. On the other extreme, the government might closely supervise expenditures to assure that the allowance is additive to housing outlays. It seems likely that some effort would be made to assure that allowances added more to housing outlays than would cash grants. One way to accomplish such an objective would be to pay housing allowances in the form of vouchers good only for payment from the recipient to his landlord (in the case of renters) of lender (in the case of homeowners). A further restriction might hold that allowance vouchers were void unless the tenant or homeowner accompanied them with a stipulated amount of cash from other resources. The problem of assuring that allowances raised housing outlays would be serious under an income-gap formula but largely absent under a percentage-of-rent formula lends itself to collusion by landlords and tenants to misstate rents for computing allowances. In either case the use of vouchers raises the threat that a black market might arise in which recipients could sell them for cash.

Second, program designers would have to decide what measures should be taken to deal with the most common and most serious objection to housing allowances—that landlords would respond to them by jacking up rents, leading to higher incomes for property owners, but not to better housing. This objection rests on presumed answers to the two crucial questions about the operation of housing markets.

How will recipients respond to allowances? Will they stay put in existing residences? Will they seek better housing but within present narrowly defined neighborhoods? Will they seek better housing outside present neighborhoods?

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[3] I have tried to explore these issues in *Why Is Welfare So Hard To Reform?*, Brookings Institution, forthcoming.

[4] Henry Aaron, *Shelter and Subsidies: Who Benefits From Federal Housing Policies?* (Brookings Institution, 1972), and "Federal Housing Subsidies," *The Economics of Federal Subsidy Programs: Part V, Housing Subsidies*, A Compendium of Papers Submitted to the Joint Economic Committee, 92d Cong., second sess., October 9, 1972, p. 592.

There is little hard evidence on exactly what recipients would do. Some badly deteriorated neighborhoods, already experiencing high vacancy rates and abandonments, might be swept by mass exodus. Residents of poor, but stable, neighborhoods might be more likely to seek better housing nearby. Decisions will be influenced by vacancy rates; by the composition of the local housing stock; and, for blacks, Chicanos, Puerto Ricans, and other minorities, by the relative strength of discrimination in local housing markets and the force of open housing legislation.

How will landlords respond to increased housing demand? Are they monopolists capable of extracting much or most of allowances in higher rents? Or will they, like other competitive producers, respond to higher demand by increasing supply. It is vital to remember that changes in the total supply of housing do not depend primarily on new construction, but rather upon the tens of millions of maintenance, repair, and improvement decisions made by landlords and homeowners each year.

While evidence on the response of property owners to a housing allowance is unavailable, a considerable amount of information suggests that, with certain possibly serious exceptions, they will behave more like competitors than monopolists. The market for rental housing is highly competitive. In most large urban areas ownership of the low cost housing stock is widely diffused among thousands of owners most of whom are quite small. Contrary to common impressions, available evidence suggests that most try hard to manage their units well and fairly, that judicious maintenance is good business, and that average profit rates are low. This evidence suggests that property owners would respond to increased demand, particularly if goaded by the threat of vacancies, by raising rents primarily in order to cover the improvements and better maintenance that tenants would be in a position to demand.

Not all housing experts would accept the foregoing description of the supply of low cost housing. Some would insist that monopoly elements are stronger Many would argue that the supply of housing to minorities is monopolistic and that discrimination would pen up the extra demand created by housing allowances and cause prices to rise far more than quality.

A third question concerns the manner in which housing allowances should be introduced. A generous universal system of allowances could be introduced simultaneously throughout the nation largely replacing increments to existing programs. On the other hand a system of allowances could be introduced gradually as a supplement to, or a partial replacement of, increments in existing subsidy programs. Gradual introducton could be managed in various ways. Housing allowances could be paid only to certain groups, such as the aged.[5] They could be introduced only in metropolitan areas, other urban areas, or rural districts in which sufficient vacant standard units existed to ease transition. They could be introduced subject to budget limitations so that within each housing market not all eligible families received them at the outset. In all cases, the limitations of the allowance would minimize the chance that a large increase in demand would disrupt housing markets or drive up prices even temporarily. Continued construction under existing subsidy programs could be used to solve any remaining transitional problems.

A fourth question concerns the measures that should accompany allowance payments to promote improved housing standards. Such measures might range from serious efforts at code enforcement to specific evaluation and approval of each unit occupied by an allowance recipient. Clearly there is a trade-off between the desire to protect the unwary and administrative costs.

To examine the effects of housing allowances, the Department of Housing and Urban Development is undertaking two ambitious experiments. Both experiments contain safeguards to assure that housing occupied by allowance recipients meets minimum standards. Under one experiment, selected families in two metropolitan areas, Pittsburgh and Phoenix, will receive allowances under vari-

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[5] In this connection, a housing allowance for the aged would be superior to property tax relief for the aged. President Nixon and others have endorsed the concept of property tax relief because of evidence that many aged families and individuals pay property taxes equal to a large fraction of income. The evidence used to establish a hardship has been questionable. But even if such hardships are as serious as alleged, and if property taxes are treated as an element of housing cost, there is no reason to single out this element of housing cost for subsidy. It would be more equitable to provide housing allowances so that the total cost of decent housing did not claim an excessive share of income.

ous formulas. Both income-gap and percentage-of-rent formulas will be used. Several variants of each will be employed. The purpose of this experiment is to discover precisely how the demand for housing changes in response to various allowances. Do families move? If so, how far, and to what kinds of neighborhoods? How much do they change housing expenditures? How sensitive are each of these kinds of behavior to various allowance formulas.

The second experiment, to measure the response of housing suppliers to a housing allowance, is far more difficult and important. Under this experiment all families in a small number of carefully chosen metropolitan areas who are eligible on the basis of income will receive housing allowances. This experiment will test the allegation that a large scale system of allowances will drive up costs rather than improve housing quality. By introducing a large scale system of allowances abruptly, this experiment will examine these allegations on grounds most favorable to critics of housing allowances. The supply experiment is far more costly and harder to design than the demand experiment and is at an earlier stage of development.

In my opinion, these experiments offer an unparallel opportunity to gain understanding about the operation of housing markets. Not only will they help in designing a housing allowance, but also they will inform most other discussions of housing policy. They will take many years to complete, however.

It is neither necessary nor desirable that implementation of housing allowances await completion of these experiments. As a practical matter, a universal, full scale allowance is unlikely to be proposed because of budget limitations. There is no evidence that the gradual introduction of a partial allowance program, in conjunction with existing, construction-oriented programs, would disrupt local housing markets or drive up prices. The inherent difficulties of any system of subsidies tied to particular units, and especially to newly constructed units, suggest that allowances be introduced. These difficulties do not suggest that existing programs should be scrapped, certainly not until a national system of allowances has become operational. The present system of housing assistance is the only device now in operation to help improve housing and residential choice for low income families. The blatant abuses of these programs can be removed by improved administration. The goal of better housing is certainly worth the cost of administrative reform.

Chairman Proxmire. Thank you, Mr. Aaron.

Mr. Downs, please proceed.

STATEMENT OF ANTHONY DOWNS, SENIOR VICE PRESIDENT, REAL ESTATE RESEARCH CORP.

Mr. Downs. I have given you a copy of my prepared statement for the record. You have also received copies of the longer report[1] which we have just finished doing for the National Association of Homebuilders, the U.S. Savings and Loan League, and the National Association of Mutual Savings Banks.

Chairman Proxmire. Yes, indeed.

Mr. Downs. I would like to point out, first of all, that all my statements and opinions are my own and do not necessarily reflect those of the Real Estate Research Corp. or its clients.

The first part of my prepared statement deals with the myths that abound concerning Federal housing subsidy programs. I think these programs have been extremely inaccurately reported on by the press and, therefore, a number of misconceptions about them have arisen and become widely accepted. In this oral statement, I would just like to mention these fallacies and state their error without stating why they are false, which is explained in the prepared statement.

[1] The report may be found in the committee room files.

The first and most widespread fallacy is that, on the whole, Federal housing subsidy programs have failed, or are not working, or somehow are a general disaster. On the contrary, I believe that, on the whole, they are effectively meeting most of the objectives for which Congress established them, although they certainly could be improved.

The main causes for their alleged failure are poor administration by HUD, and the tendency to use shelter instruments to cope with serious nonshelter problems which society refuses to meet with more appropriate instruments. I mean poverty, the destructive behavior of certain households, and the concentration of poor people together. These are not failings of the basic design of the present subsidy programs, which are rather well designed in most cases, but rather failures of our willingness to deal with these problems separately.

The second myth is that housing subsidies mainly benefit the poor. As Mr. Aaron just pointed out, the largest subsidy, comprising two-thirds of total subsidies, is the tax savings on mortgage interest and property taxes enjoyed by homeowners. In using his calculations, on just the deductibility part of it, not the imputed income tax savings, almost two-thirds of these savings go to households with incomes above $10,000. In fact, the Joint Economic Committee's own report made by its staff indicated that this saving from deduction of mortgage interest and property taxes was about $4.7 billion in fiscal 1971 and was, therefore, over two-thirds of the total subsidy cost which that report showed was attached to housing. So it is the affluent and not the poor who are the chief beneficiaries of housing subsidies.

The third myth is that use of interest reduction subsidies is immoral, concealable, and hides true subsidy cost. I think this myth was highlighted in the statement which your own committee put out, Senator. This is no more true than that the borrowing of any money to buy a home results in immoral cost, in my opinion.

The fourth myth is that new construction subsidy programs raise housing prices. They do raise construction costs if they cause a significant increase in output, which they have, but they tend to lower the prices of existing housing units by adding to the competitive supply.

The fifth myth is that there is some less expensive and somehow more effective way of meeting the Nation's housing needs than present subsidy programs. I do not believe this is true. I do not think a housing allowance, specifically, is either less expensive or more effective. It is no less expensive than the present subsidies if it also fully meets the needs it is designed to serve. A housing allowance would be a shorter range program. However, even if it had annual appropriation, it would became as long lived as welfare has, because it is essentially an income maintenance program. Or the main cause of what is usually called our housing problem, I agree with Henry Aaron. I would add poverty to the list of causes he cited—bad neighborhoods and poor public services. I think poverty is really the main cause, and there are no inexpensive ways to attack poverty effectively.

The attitude of people who reject the present system and opt for some untried system reminds me of the prince judging the singing contest in which there were two contestants: immediately after hearing the first contestant sing, the prince awarded the prize to the second

contestant. We have not heard the second contestant sing yet; in fact, we have not really listened very carefully to the singing of the first contestant. I think it is a little premature to take the prize away from the first contestant already on stage and give it to the second contestant.

The sixth myth is that housing subsidies are not needed because the market system can meet national needs alone. The market system, which is an excellent system for the majority of Americans, has also generated the income distribution that has left 26 million people in the United States poor, and millions living in dilapidated housing. I think the market system is a great system, but it also requires some intervention to help overcome its faults. Our subsidy programs represent some of that intervention.

The seventh myth, which is not mentioned in the prepared statement I submitted but is covered in my report, is that default rates in subsidized programs, especially sections 235 and 236, are very high and will ruin the finances of FHA and HUD. I believe this is absolutely false. More than 90 percent of all the units subsidized directly in these programs are in no financial difficulty. Those programs which have experienced difficulty are mainly not direct subsidy programs but market rate programs, or those allowing special terms in high risk areas or to high risk borrowers.

The second part of my prepared statement deals with certain background factors about the Nation's housing strategies, and I will skip that in my oral statement. The third part sets forth alternative subsidy policies and effects in terms of our overall urban development strategy. I do not have time to cover all these points, so I want to make just a few key observations.

First, I think it would be a mistake to eliminate or substantially reduce all new construction-oriented subsidies, and on this point I believe Mr. Aaron and I do disagree somewhat. I believe we need ways of allowing low- and moderate-income households to live in brandnew housing if we want to have an economic integration at all in new growth areas.

New growth areas means those areas in which the 66 million more Americans who are going to be added to our population between now and the year 2000 are going to live. If we want any significant rebuilding in our inner-city neighborhoods, those neighborhoods would have to have some new construction too. I presume some of the present residents who are living there now would like to stay there and live in some of that new construction.

Those kinds of actions require the relatively high per unit costs needed to allow low- and moderate-income households to live in new construction in order to be near and integrated in the same community as wealthier households. If we fail to provide the possibility of poor people living in brandnew housing units, which a housing allowance does not allow, then we cannot either give the poor access to our rapidly growing suburban job frontier or achieve any significant slowdown in the spread of inner-city urban decay.

Second, I think it is a mistake to believe that all housing needs can be met by a housing allowance. As I pointed out a moment ago, we need some new construction subsidies and a housing allowance would

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never be funded sufficiently by Congress to pay for low-income households to live in new housing units. In fact, one of the advantages which Mr. Aaron points out in his opinion is that it would not allow people to live in new housing—poor people—because then they would be living in better units than people with higher incomes than themselves.

Also, a housing allowance mainly raises people's incomes rather than improving their housing, and I do not think there is any way to escape that fact. Most people who are eligible for a housing allowance are already living in decent housing. Their problem is low income, which results in their paying a high fraction of their income for the housing they are living in. In the 1960 census, over three-quarters of the households with $2,000 in income or less were living in standard quality units. It is poverty that is their problem, not poor quality housing.

In addition, a housing allowance might cause rapid inflation in housing prices and in ghetto areas and, therefore, injure more people than it helped. I believe the housing allowance might be far more expensive than existing program. One of the key advantages of the housing allowance, supposedly, is its equitable treatment of all people whose income is the same. This advantage is immediately sacrificed by the proponents of the housing allowance when they start talking about the real world because they start talking about how to cut back the costs by leaving out certain households and, therefore, making the system inequitable. Mr. Aaron did this when he suggested restricting the elderly or some areas, which means it makes the program inequitable by not treating all people of like incomes the same. I do not think it is reasonable to have a housing program that is not equitable, that does not treat all people the same. There are other objectives besides equity of treatment, and there are other objections if to sacrifice equity of cost we have to sacrifice equity of treatment.

To cut back sharply on those direct subsidy programs that benefit the poor or near poor—such as public housing and sections 235 and 236—while leaving the indirect subsidies that benefit the more affluent untouched is just what the administration is likely to propose, in my opinion. I regard that as socialism for the rich and free enterprise for the poor, hypocritically done in the name of economizing. I do not think that is in the tradition of fairness to the oppressed that I presume you stand for, Senator Proxmire, and I hope you will oppose it.

Finally, I think we cannot consider housing subsidies apart from our whole urban development strategy. At present, we do not have any explicitly stated and well-defined strategy, but we have a very effective, implicit strategy. That strategy is the "trickle-down process," which benefits the upper two-thirds of the income distribution at the expense of the bottom third. In our metropolitan areas, it forces the bottom third to concentrate together in neighborhoods with extremely negative characteristics because we deliberately exclude them from the neighborhoods in which the other two-thirds live. Direct housing subsidies provide a means which we could use, and are now beginning to use, to rectify that injustice. I hope we will move more in that direction, rather than backward toward complete dominance of urban development by the unjust "trickle-down" system, which prevailed almost without modification until the 1968 Housing and Urban Development Act expanded direct housing subsidies.

That is a highly inadequate summary of this very complicated situation, but I think it presents the main points from my prepared statement.

Thank you.

(The prepared statement of Mr. Downs follows:)

PREPARED STATEMENT OF ANTHONY DOWNS [1]

HOUSING SUBSIDIES AND ALTERNATIVE STRATEGIES FOR URBAN DEVELOPMENT

Present direct housing subsidy programs have generated a tremendous amount of confusion and misinformation—in the press, in local communities, and even in the Department of Housing and Urban Development. If national policy is to effective, it must be rational rather than based upon erroneous perceptons. Therefore, the widespread fallacies now causing distorted evaluations or housing subsidy programs must be exposed, and the truth given greater visibility.

I believe I can contribute to this clarification process because Real Estate Research Corporation has just completed a one-year analysis of existing and proposed federal housing subsidy prigrams. We think this is the most extensive, objective analysis of the subject to date. Although the study was jointly sponsored by the National Association of Home Builders, the National Association of Mutual Savings Banks, and the United States Savings and Loan League, we undertook the assignment only on the explicit condition that we would express the facts as we saw them, regardless of their impacts upon public policies or upon the interests of any particular groups, including the organizations that funded the study.

As the Committee is fully aware, the subject of housing subsidies is extremely complex. This is an inescapable result of the fantastic complexity of the entire process of urban development in the United States. In a short time, one cannot discuss all of the American housing provision process. I will therefore describe some prevalent myths about housing subsidies, and then discuss alternative strategies concerning national housing subsidy programs.

COMMON MYTHS ABOUT HOUSING SUBSIDIES

The mose dramatic and most often repeated myth is that federal housing subsidy programs as a whole have failed, are disastrously ineffeetive, or are not working. I believe this is false. Most of the more than 2.3 million housing units produced in the last 35 years through *direct* housing subsidies are highly satisfactory to their occupants, and have never experienced financial difficulty. Moreover, four of the primary objectives of housing subsidies adopted by Congress have been effectively served by existing programs since 1968. These objectives are: meeting the physical housing needs of urban low- and moderate-income households, encouraging home ownership, stimulating the economy through greater housing production, and increasing the national supply of decent housing. (Two other primary objectives that have been only partly fulfilled are meeting the financial needs of urban low- and moderate-income households and improving deteriorating neighborhoods. One primary objective very ineffectively served is meeting *rural* housing needs.) If directly subsidized housing starts remain at close to 400,000 units annually for several more years, the four objectives listed above will continue to be met effectively.

In reality, most of the supposed failures of housing subsidies result not from any major faults in their design, but from two aspects of how they have been used in practice. One is poor administration, and the other is use of shelter instruments to deal with vexing non-shelter problems that society refuses to treat more directly. Examples are poverty, destructive households, and concentration of the poor together, which results from deliberately excluding them from middle- and upper-class neighborhoods. Housing subsidies cannot cure these problems, through they are a necessary element in any effective cure. So far, the American public has been unwilling to adopt the other necessary elements. It is unfair to fault housing subsidies for not solving social problems they were

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[1] The opinions and conclusions expressed in this testimony are those of Anthony Downs speaking as an individual, and do not necessarily express the views of Real Estate Research Corporation or any of its private or public clients.

not designed to solve. Moreover, it would be unfortunate if housing subsidy programs were abolished for this failure and no other programs were adopted. That wold mean giving up altogether on the problem of concentrated urban poverty.

A second myth about housing subsidies is that they primarily benefit very poor households—especially those on welfare—and unfairly penalize hard-working middle-class taxpayers. This myth ignores the single largest housing subsidy, two-thirds of which goes to households with incomes above $10,000. That subsidy consists of tax savings from deducting mortgage interest and property taxes from federally taxable income. This indirect housing subsidy does not appear in the federal budget, but it is nonetheless real. It amounted to $5.7 billion in fiscal 1971—more than twice as much as all direct housing subsidies combined.

A third myth is that use of interest reducing subsidies somehow "hides" true subsidy costs by deferring them to the future. Borrowing is a standard method of spreading large initial costs over time, and most housing is financed that way in the United States. Faulting subsidy programs for using this method is like saying that millions of homebuyers are immorally hiding the true costs of their homes by borrowing under conventional mortgages. Interest reduction subsidies do result in larger total lifetime costs than direct capital grants would, but the difference is substantially reduced by the fact that future dollars do not have the same value as present dollars. Also, deferred costs have a lower impact on the federal budget and produce far more units per dollar spent now than would capital grants. In addition, direct comparisons of maximum lifetime interest subsidy costs with capital grant costs fail to consider income rise-out provisions of the 235 and 236 programs. In the latest recertification of incomes for Section 235 homebuyers, 74 percent received reduced subsidies, including eight percent who stopped getting the subsidy altogether.

A fourth myth is that new construction subsidy programs raise housing prices. In fact, such subsidies raise construction costs but exert downward pressure on the prices of existing housing by adding to the competitive supply. A housing allowance, in contrast, would push up the prices of existing units.

A fifth myth is that there is a cheaper way to achieve Congressional objectives concerning housing than the present subsidy programs, which are mainly construction oriented. Most schemes that are promoted as cheaper simply serve Congressional objectives to a lesser degree, or understate the costs that would really be involved. A nationwide housing allowance, for example, would not be cheaper than present programs if it met housing needs as fully. Actually, it might prove costlier in the long run, especially if it drove up the prices of existing housing units significantly. Also, like the welfare and Medicare programs, it is legally a short-run program, but in reality involves a political commitment of indefinite duration. In contrast, the mortgages in Sections 235 and 236 do have finite terms.

A sixth myth is that housing subsidies are not needed because the market system can meet national needs alone. Housing subsidies comprise some of the many devices we use to cope with the poverty that arises from the income distribution produced by existing markets. If having 26 million people in poverty (with annual incomes below $3,900 for a four-persons household) is satisfactory, and if having several million households live in dilapidated dwellings is satisfactory, then existing markets can indeed meet national needs adequately. If these conditions are not satisfactory, some type of non-market intervention is necessary. Even if poverty were removed through income maintenance and job creation, some public stimulation would be required to expand the supply of housing to meet physical housing needs so as to prevent housing prices from rising unduly.

Additional myths about housing subsidy programs abound. However, in comparison to the six discussed above, they are relatively minor and focus upon particular aspects of subjects already covered. Real Estate Research Corporation's full report includes analysis of well over 75 general and specific criticisms of the present subsidy programs.

THREE KEY BACKGROUND FACTORS TO CONSIDERATION OF ALTERNATIVE HOUSING SUBSIDY STRATEGIES

Before discussing alternative future housing subsidy strategies, I would like to mention two key background factors concerning them. First, the United States already has an implicit urban development strategy, which has dominated our urban settlement patterns for several decades. It is what I call the "trickle-down" process. We rigorously enforce high-quality construction standards for all

new housing units (except mobile homes), which are normally built on vacant land near the edges of built-up areas. Since these high-quality standards make new units expensive, only people in the upper half of the income distribution can afford to occupy them. Poorer people must live in older units, which are less expensive. They cost less because they are obsolete and we have allowed them to become deteriorated by failing to enforce legal quality standards concerning them with the same rigor we use in the new-growth areas.

Since older units are clustered in the central parts of our urban areas, and since we exclude poor people from the newer peripheral parts of those areas, this process of letting the poor occupy older units that have "trickled-down" causes them to become concentrated together in the oldest parts of our cities. Such a concentration of thousands of the poorest and least capable households together in the worst quality housing produces a terribly destructive environment. It is dominated by poverty, crime, drug addiction, vandalism, and the other undesirable conditions so well described in accounts of "crisis ghetto" life. This is the price society pays for the fine quality environments achieved by the middle- and upper-income majority by excluding the maladies of poverty from their neighborhoods. However, this price is not paid by those who receive the benefits—rather it is paid by the poorest people in society, who are least capable of bearing its burdens. Moreover, this entire process is reinforced by our present structure of housing subsidies, since we give the biggest subsidy to households who own their own homes—and the more affluent they are, the bigger the subsidy they get per household. Thus, our housing subsidy strategy reinforces the impact of high-quality standards in benefiting the upper half of the income distribution at the expense of the lower half.

The second background factor concerns the impact of total housing production upon the effectiveness of any housing subsidy strategy. The most important decision we will make concerning subsidies is not about them directly, but rather about how much we will stimulate total housing production through the many public-policy devices now used to increase it. If huge amounts of new housing continue to be built primarily in the suburbs—as in 1971 and 1972—more and more middle- and upper-income households will be drawn out of central cities. Those areas cannot compete with new suburbs as desirable places to live. The central-city housing inventory is older, and the concentrations of poverty there, with their attendant social problems, drive households with money out to the suburbs. Suburbs have almost totally dominated metropolitan-area employment growth in recent years, and many older central cities have suffered serious economic declines. Middle-class families have little motivation to stay in central cities when they can live in the suburbs near more jobs, in newer units, in better neighborhoods, with less crime.

Rising abandonment in many central cities is caused, in part, by the success of our official strategy to "flood housing markets" with 2.6 million or more units per year. Since the vast majority of these units are built in the suburbs, middle-class flight from central cities is accelerated. Continued high level housing production would not unduly hurt central cities *if* it were accompanied by three actions:

Dispersal of a high proportion of new low- and moderate-income housing outside central cities.

Introduction of new means of *neighborhood management* in inner-city areas to improve security and to limit housing abandonment to units that should be demolished.

Performance of significant *urban renewal* in decaying areas.

If these actions were undertaken, high production would help to remove blight and to promote rebuilding of decaying areas. Without these actions, high production will cause further spread of inner-city decay in many larger, older cities.

The third key background factor is the difference between two different conceptions of housing "needs." I think much present confusion about housing subsidies can be cleared up by differentiating between *financial* housing needs and *physical* housing needs, as follows:

Financial housing needs result from "gaps" between the actual cost of decent quality units and the amounts that low- and moderate-income households could devote to housing if they spent a "normal" percentage of their incomes on it. Subsidies designed to reduce such "income gaps" can reduce effective occupancy costs, or raise household incomes, or both. For example, consider a four-person household with an annual income of $3,000. Some

experts consider 25 percent of income as the "normal" fraction such a household can afford to spend for rent. If a decent-quality apartment costs $1,200 per year ($100 per month), that is $450 more than 25 percent of the household's income. So this household has a financial housing need of $450 per year. Most households with financial housing needs already live in decent-quality units, but they pay high fractions of their income to do so because they are poor. Hence meeting financial housing needs is mainly a matter of raising the incomes of the poor, rather than improving their housing.

Physical housing needs arise when there are not enough decent-quality housing units in existence, and at appropriate locations, so that every household can occupy one, regardless of how much it must pay to do so. Many poor households cannot afford to occupy units meeting legal minimum quality standards. Therefore, non-subsidized private housing production alone cannot eliminate physical housing needs as long as present quality standards prevail. Subsidies can be used to meet such needs by expanding the output of housing to larger totals than the private market would generate alone.

The national housing goal of creating 26 million additional units from 1968 through 1978 is essentially based upon fully meeting the nation's physical housing needs by that date—including all such needs accumulated in our past history, and those which will arise from now through 1978.

ALTERNATIVE HOUSING SUBSIDY STRATEGIES

Many different alternative future strategies could be adopted concerning the use of housing subsidies. In choosing among the alternatives, it is critical to analyze the ways in which subsidies would relate to key facets of future urban development, especially since this aspect has been almost completely ignored by the press.

This type of analysis of five alternative strategies is summarized below. In each case, the relation of the action to urban growth and development in general is described. These five strategies are by no means the only possible ones. However, they illustrate the major types of alternatives that are available. Briefly, they are as follows:

1. *Abolish all direct subsidies without replacing them.* If this action were taken, the indirect subsidy of income tax savings to the relatively affluent would dominate the nation's housing strategy. Sole reliance would be placed on the "trickle-down" process to house the lower half of the income distribution. If overall housing construction continued at a high level, more middle-class households would be drawn to the suburbs from the central cities. Inner-city decay would spread as the poor were concentrated in larger and larger areas.

Abolishing direct housing subsidies would not reduce the present federal budget since it contains commitments for units that have already been built. Future increases in subsidies for the poor would be stopped, however, which would prevent them from rivaling the size of the subsidies for middle- and upper-class homeowners.

We would then have what might be called socialism for the rich, and free enterprise for the poor.

2. *Abolish all direct housing subsidies, but adopt extensive income maintenance and job creation programs.* This strategy would attack poverty directly without special regard for housing. It assumes that rising incomes would cause the housing industry to supply sufficient good units to inner-city residents. Experience with welfare housing allowances indicates that this would not happen. Nevertheless, the poor would certainly be better off under this strategy than they are now.

3. *Abolish all present direct housing subsidies and replace them with a housing allowance.* This would shift emphasis from new construction of housing for the poor to more intensive use of the existing inventory to meet their needs. However, it would also cause a sharp increase in the price of all existing older housing—just as the rapid expansion of demand for health care under Medicare and Medicaid caused doctor and hospital fees to soar.

A housing allowance that fully meet financial housing needs would not be less expensive than present direct subsidy programs, though more people would benefit. The money would actually be spent largely on non-shelter items since most poor households already live in decent quality units but pay high fractions of their incomes to do so.

4. *Continue to emphasize new construction-oriented programs for low- and moderate-income households at high levels of output.* This approach focuses upon meeting physical housing needs, not financial ones. Hence, the poor quality housing in America would be replaced, but the incomes of the poor would not be raised to enable them to live in decent quality units at "normal" fractions of their incomes. This strategy would stimulate some economic integration in new-growth areas where job opportunities are increasing, which would not happen if only a housing allowance were used. This approach would also encourage creation of certain types of units that are not sufficiently present in the existing inventory and are unlikely to be built by private developers without subsidies (e.g., large multi-bedroom, modestly priced rental units).

5. *Develop a mixture of new construction-oriented subsidies and housing allowance-type subsidies, varying the blend to meet differing local housing market conditions.* This policy could be attained by expanding existing programs that are like housing allowances (e.g., public housing leasing) and expanding housing allowance experiments. If housing allowances were used only in areas where ample housing units existed, or were used in concert with new construction subsidies, prices of existing older units would not escalate. Though this strategy would produce nearly ideal results, its administration could prove more complex than HUD—or any other public agency—would be able to handle effectively.

CHOOSING AMONG ALTERNATIVE STRATEGIES

Rationally choosing which subsidy strategy to adopt depends upon the goals we want to pursue. If the major goal is to continue the existing separation of middle- and upper-income groups from the poor, then dispersal of low- and moderate-income housing outside older parts of central cities should be avoided. In that case, the number of *direct* new-construction subsidies must soon be reduced. Builders are running out of non-suburban sites for such units, and some economic integration is beginning to occur. A housing allowance or income maintenance program would limit economic integration because Congress would not provide per-household benefits large enough to allow poor people to live in brand new units—yet there are no old units in new-growth areas. So would elimination of all housing aid to the poor.

If the nation's main goal is to counteract urban decay and replace poor quality units while meeting population growth needs—as stated in the Housing and Urban Development Act of 1968—dispersal of the poor and redevelopment of central cities both must be accelerated. However, it appears that such actions would violate the preferences of the middle-class majority demonstrated in the recent election. Hence this choice—which I strongly favor personally—seems politically unlikely at present.

If society's main goal is to raise the incomes of the poor while rejecting them as future neighbors, income maintenance and housing allowance programs can be used, along with some new construction in ghetto areas. However, to keep people with rising incomes from abandoning inner-city areas, total housing production would have to be cut back to re-institute an overall housing shortage. Otherwise the poor will move out of ghettos as fast as their incomes rise. In the long run, such "enrichment without dispersal" will not work because it fails to deconcentrate the poor. Hence it does not reduce the social problems that accompany concentration of poverty.

CONCLUSIONS

The tangle of complex issues usually referred to as "the housing problem" derives principally from three factors: poverty, enforcing high quality standards for housing in new areas while disregarding them in older areas, and the unwillingness of middle-class households to accept poor families as neighbors. These are not primarily building or shelter problems in any technical or financial sense. Rather, they are problems rooted in fundamental conflicts of interest in American society—mainly between the poor and the non-poor.

Ways exist to resolve these conflicts and allow both groups to achieve their major goals. However, they can only be used if both population groups are willing to compromise somewhat. At present, the politically dominant majority—the middle class—does not appear willing to compromise by paying the money and non-money prices necessary to help the politically weak minorities who comprise the poor (I mean numerical, not ethnic, minorities). Thus, our present

failure to "solve the housing problem" does not arise mainly from ignorance about what to do, but rather from our unwillingness to make use of existing knowledge.

In fact, the appealing idea that all problems are soluble in some technical or external sense is a delusion. Many of our most serious domestic problems arise from the ambiguities and conflicts of society's desires. The recent election shows that Americans as a whole do not want to move very rapidly away from public policies that maintain the dominance of the middle class through systematic subordination of those at the bottom of the social and economic pile. In urban affairs, as in other arenas, the weakest and least competent persons in society bear the heaviest costs for arrangements that aid the more affluent and capable majority. This is strikingly demonstrated by the fact that it is the relatively few unemployed workers who bear the major cost of stopping inflation, which benefits the middle-class majority. The majority does not want to end such arrangements, in spite of their injustice, because too much is to be gained from continuing them.

In a similar fashion, the present urban development process inherently generates major problems in older central-city neighborhoods by concentrating large numbers of low-income households there. Society could best deal with the serious problems in these areas of concentrated poverty by such non-housing programs as adequate income maintenance, creation of jobs, large-scale family and personal counseling, major reform of the criminal justice system, and dispersal of the poor throughout non-poor areas. However, neither public opinion in general, nor Congress, nor the Administration appears willing to bear the costs of carrying out these programs at the scale necessary to cope with the problems effectively.

Until programs are introduced that directly address these major non-shelter problems on a much more adequate scale, it will be more effective to use direct housing subsidy programs to help deal with them to do little or nothing about them—even though this will cause some of the housing subsidy programs to appear ineffective or very costly in providing shelter *per se*. Even if adequate non-housing programs related to poverty were adopted, large-scale direct housing subsidies for new construction would still be needed to expand the supply of decent housing units available to low- and moderate-income households.

Chairman PROXMIRE. Thank you, Mr. Downs.

Mr. Emmer, please proceed.

STATEMENT OF PHILIP I. EMMER, PRESIDENT, EMMER DEVELOPMENT CORP.

Mr. EMMER. Good morning.

I agree that our housing programs and policies are having real troubles. In my opinion, the overwhelming reason for this is because of the ineptitude and inadequacies of HUD starting at high levels and extending down to a number of decisionmakers and technicians in the local offices. I think this accounts for most of the woe we have and will continue to face. Since time will not allow it, just put me down for about 2 hours of examples of things that have gone wrong and I can give it to you. Changing this decline is going to be difficult but necessary, and I would like to give you some of my thoughts on starters.

The area office concept, while possibly fine in theory, just has not been working. In my view, things have been getting worse in these offices. I am not the only one that can tell you that not only is work not being accomplished, but now even mail and phone calls go unanswered. It seems that everyone is always in meeting with everyone else and nobody is left to do work. My meetings with FHA officials used to consist of me and one or two of them. Now, typically, there are six, eight or 10 HUD people called in for meetings, often on the most routine of matters. And, still, the poor communications and snafu's go on unabated.

All of HUD, it seems, is bogged down by bureaucratic pollution. I will be frank to admit in my own business that I have seen 10 people, all trying their best, accomplish less work than five. I do not agree with those who claim HUD is understaffed. In my judgment, they are underdirected.

Local FHA and HUD offices are directed by political appointees. Many of them should not be there. I am told that some Government agencies have been removed from politics. I think this is essential with HUD in order to eliminate political favoritism and indebtedness, unknowledgeable directors, and to improve the technical capabilities of the offices.

During the past few years, HUD has been practically reorganized out of existence. This must stop. Morale is so low it is nonexistent, and it seems to me that housing production has become totally secondary to job protection. In other words, it appears to me that there is almost a total breakdown of the ability to function. To regain lost ground will require inspirational leadership and management ability of the highest caliber.

Therefore, I must conclude that a very high portion of the problems existing today have been caused by a well-intended but poorly executed management function.

Assuming that the aforementioned did not exist, I suppose you would like to be able to judge the effectiveness of the subsidy programs. My best answer would have to be that it is a mixed bag, but a good mixed bag. A little later I will offer some small suggestions to make them a teeny bit better. Based on everything I know and hear, I just think it has got to cost a bunch of money to house poor people. You have to make up your mind how much we can afford to spend for this function of Government and who we should house. Now I would like to comment on some of the specific issues.

There has been a lot of talk recently about housing allowances. I would not be against them if someone could explain to me how they will help to increase housing production. If there would be some way to tie the two things together it would be just fine. And for what it is worth, I do not talk about housing production because I am a housing producer, but because too much demand and not enough supply will sure enough knock things out of whack. Tony Downs says it much better than I do.

I think that at least some of the thought behind housing allowances may be to promote racially integrated housing which has not seemed to work too effectively in the other subsidy programs. Maybe it will work more efficiently here, but from what I have been able to observe, I have some doubts. Nevertheless, this could be one of the most promising methods of achieving some higher level of integration than what we now have.

Basically, the 235, 236, rent supplement and public housing programs all go part of the way but they can all be improved. Just as one example, there is one thing so easy to do that I cannot for the life of me understand why you do not do it the day after Congress reconvenes. The way the law reads, a family that qualifies for a 235 house would receive, in my area, for example, about a $90 subsidy on a $180 payment. If a family made 1 dollar per year over the maximum, they

could not qualify at all. Elimination of income limits but not of maximum house prices, would open the program to many families of modest means who do not need a maximum subsidy, thereby spreading the same total number of dollars to more families, thereby eliminating jealousies and frustrations and spreading support for the program. It is likely that the percentage of foreclosures would be reduced and a better economic mix of families would result. If you can find one thing wrong with the premise, I would like to hear it.

I must agree with Senator Proxmire and others who believe our housing programs are far too complex. At the same time, I must also state that the 1972 housing bill sure was not a simplification. I have some ideas on this which I will mention in a minute. I do not see any reason to have even the number of subsidy programs kept in that bill. If you really want to get down to basics, why, for example, do we need both public housing and rent supplements which are both meant for the same people? All too often, when housing economists start to work with numbers, they leave some out. For example, the subsidy given by local government for public housing units owned by local authorities where most real estate taxes are waived; as compared to 235, 236, rent supplement and leasing programs where full real estate taxes are paid. Is there any logical reason for the difference? There are other cases of making numbers do tricks, too many to enumerate here.

I would agree with Senator Proxmire that we ought to be financing housing with the lowest net cost to the Treasury. If Government interest payments and discount absorption does cost an extra $200 million a year, then I cannot see why our building industry would not support a return to direct Government lending.

I do not think enough attention has been focused on the beneficial economic impact of housing subsidies which are related to new construction. I have heard housing economists talk about the "multiplier effect" of new housing, which I am sure you people understand much better than I. Assuming some fair margin of profit for the land dealers, the subcontractors, the suppliers, the appliance manufacturers, the furniture people, the paving contractors, and occasionally even the homebuilders, there should be a fair amount of this subsidy money returned to the Treasury each year by the industry causing its expenditure in the first place. If the alternative were no new housing at all, I think you can see the value of the tradeoff.

Therefore, on balance, I must conclude that the subsidy programs are good, are necessary, but can be substantially improved.

Senator Proxmire has stated that insufficient effort has been made to reduce housing costs. Not by our industry—we have been working at it for a long time. In truth and in fact, it appears that Federal, State and local governments have been exerting all-out efforts to increase housing costs, and from where I sit, it looks like they have been too successful. How about these examples: OSHA; Davis-Bacon; project selection criteria; environmental clearances; tree ordinances; density and zoning ordinances; paperwork and redtape; equal employment opportunity; affirmative marketing; mandatory land grants, and so on. I do not necessarily argue that these things are bad, but they are costly. And, certainly, the overreaction to the FHA 235 program is adding too much cost in the very area it needs to be reduced. There are a few specific suggestions I would like to make.

One of the problems in the FHA programs is that of a return of and on capital. I would propose that you might look at the possibility of a 100-percent mortgage for profit-motivated sponsors similar to what is now available for the nonprofits. This could possibly be a viable alternative to the sale of tax shelters. For those who are especially critical of so-called tax shelters, I believe you should look at the picture from the builder's side. If there was not a way to recapture capital and make a profit, he would not be willing to go into the program.

For a number of years I built about 60 or 80 houses per year in Gainesville and slightly less in Pensacola. For this work I received some amount of recognition from Secretary Weaver, many others in HHFA and FHA, House and Home Magazine, NAHB, the National Urban League and others. I thought I was a hero but last year I became a bum for continuing exactly the same program, because now my subdivisions did not provide for the dispersal of the minorities. No matter that I was up to my neck trying to make equal employment work, or that we were still doing free counseling or that we were practically the only low-income-housing producer, or that there was always a waiting list to buy our houses.

Now, the result is that in place of our good new housing which, as far as I know, has never been subject to criticism from any source, there is practically no new housing for the families I served. They have not been dispersed, just crowded. In essence, I was told I could continue building in this area for white people, but not for blacks, so what this amounted to was that the white folks could live anywhere, but the blacks could live only in selected locations, none of which they preferred. As a result, I am now out of this low-income business and I own a lot of land bought for a specific purpose but which I cannot use. This is not an isolated case. I know of many others in the same boat.

I would propose that consideration should be given to eliminating the role of the nonprofit sponsor in housing production and carefully studying the possibility of an increased role in housing management. To me, this is simply proposing that every entity do what it can best. I know that I could not do much of a job running a church or a rescue mission, and the converse may be true.

There is not much incentive to save money or build efficiently in the FHA multifamily programs. It would be relatively easy to remedy this problem simply by allowing a cost reduction incentive similar to what is now done for nonprofit sponsors.

Cost certification rules are typical of the kind of complexity that becomes legendary in a bureaucracy. I am convinced that anyone who has made up his mind to do so can be dishonest even with cost certification. My suggestion is that it be eliminated entirely and replaced with other easy safeguards. Remember, there is no cost certification in conventional lending, just maximum mortgages, which seem to do it all.

Prevailing wages as required by Davis-Bacon have outlived their usefulness and consideration should be given to their repeal. They have contributed substantially to higher costs because of the way they have been handled.

For a number of years, I built about 60 or 80 houses per year in Gainesville and slightly less in Pensacola. For this work I received some amount of recognition from Secretary Weaver, many others in HHFA and FHA, House and Home magazine, NAHB, the National Urban League and others. I thought I was a hero but last year I became a bum for continuing exactly the same program, because now my subdivisions did not provide for the dispersal of the minorities. No matter that I was up to my neck trying to make equal employment work, or that we were still doing free counseling or that we were practically the only low-income housing producer or that there was always a waiting list to buy our houses. Now, the result is that in place of our good new housing which, as far as I know, has never been subject to criticism from any source, there is practically no new housing for the families I served. They haven't been dispersed, just crowded. In essence, I was told I could continue building in this area for white people, but not for blacks, so what this amounted to was that the white folks could live anywhere, but the blacks could live only in selected locations, none of which they preferred. As a result, I'm now out of this low-income business and I own a lot of land bought for a specific purpose but which I can't use. This isn't an isolated case, I know of many others in the same boat.

You raised a question about why the quality of subsidized housing varies so greatly. Basically, FHA has all the tools to see that all the procedures are followed and the quality should not suffer. I have read and heard some of the same stories you have, and I can only surmise that there are dishonest people in every field of endeavor. It is ridiculous, however, to cure the disease by killing the patient, which is being done by regulation after regulation, restriction after restriction, and safeguard after safeguard.

I have about a half page, do you want me to finish this?

Chairman Proxmire. Yes, finish it.

Mr. Emmer. The procedures and laws by which foreclosed houses are recaptured are indeed a disgrace. Not being a lawyer, I am not qualified to discuss the legal nature of foreclosures, but my observations of watching the physical disintegration of housing by vandalism, and having experienced the ease with which deeds can be gotten from a delinquent owner, I am convinced that these foreclosure costs could be substantially reduced in every case, and by as much as 75 or 80 percent, sometimes more, in ideal cases.

This is an interesting and quite involved field. I would suggest that you inspect the report of the demonstration program that we conducted several years ago in Gainesville. It contained dozens of ideas we developed during our experience in day-to-day dealings with low-income families. Typical of these was our belief that the use of the 13-month year would be most helpful to the families and would avoid a huge percentage of foreclosures. This added indulgence of allowing a family, when under financial stress, to occasionally miss a payment, and in effect slightly restructure the mortgage, could possibly be one of the most fruitful ways to reduce foreclosures, and equally as important, the human wear and tear that comes to a family forced out of their home. We had lots of ideas like these, but time does not allow for detailed discussion now.

By the way, I believe it was the intent of Congress to run counseling programs hand in hand with the sales of 235 houses. I do not know why funds and procedures were never set up to handle these programs, but they were not. Counseling is not easy. I think HUD instituted some method of forming a program last year. I believe they allowed $100 per family to be paid by the builder on some sort of experimental program. I can tell you more than money is needed. It will not work unless a real substantive program goes with it.

Like every American concerned with decent housing, I certainly hope you are successful in reaching the right decisions from all the testimony you receive. In rereading these remarks, I note they appear to be self-serving in that too little criticism was directed at our industry and too much at others. We have our faults too, but I suppose it is in the nature of things that you will have to hear of them from others. You have plenty of volunteers for that. As for me, I think we do a creditable job.

Thank you.

Chairman Proxmire. Thank you, Mr. Emmer. Thank all of you gentlemen for very, very helpful and interesting statements.

I would like to ask each of you, to begin with, to give me assessment of the HUD performance in view of the limitations they have and the problems they undoubtedly have with the kind of legislation we have adopted and a difficult problem of providing housing in a free country and free society as diverse as ours is, but with that in mind I would like to ask each of you to comment briefly: How does HUD perform—how does HUD perform within the present framework? I realize, Mr. Aaron, you have a view the framework is not adequate, in the present framework of the law, of getting housing to families most in need.

Mr. Aaron. I think the primary difficulty in getting subsidies to families most in need relates to the way, as you say, the way in which the program is designed. In fact the very lowest income families cannot afford section 235 and 236 housing even with the quite deep subsidies provided under these programs. The very poorest families can be accommodated only in low-rent public housing and rent supplements. Subject to these problems, HUD has done a fairly good job in getting housing to the groups that calculations would suggest ought to be served by each subsidized housing program. I am sure there are instances of failure, and practices vary widely across the country. But the broad statistics suggest that, within each program, HUD has gotten housing to intended beneficaries.

Chairman Proxmire. Mr. Downs.

Mr. Downs. Well, to the poorest people the main programs that are available are 235, public housing, and 236 rent supplements. I think the greatest difficulties encountered in those programs are not those of administration by HUD, but the reaction of local communities and the middle class to living with poor people.

Chairman Proxmire. How can HUD or how can the Congress ever overcome that or can it ever be overcome?

Mr. Downs. Well, partly by making the range of people who can live in subsidized housing slightly larger, which the 236 program was intended to do; partly by increasing their incomes so there will

be some integration in individual projects; partly by using some kind of housing allowance type programs that go to the individual households and not necessarily to the units. We already have the public housing leasing program, which makes the latter possible. If that were extended, it could be run essentially as a housing allowance program now.

Otherwise, it is difficult to do that without some nationwide strategy and leadership to work toward how households of low income are going to live in our middle-class communities. Right now we deliberately exclude them from our middle-class neighborhoods and concentrate them together and then say, "Isn't it awful that all of these conditions occur. We do not want them to live with us."

Chairman PROXMIRE. Let us illustrate this in terms of income to the 235 and 236, do you think that is administered, so as to provide for those who are eligible, in other words, they are not the neediest people in the society but those who could swing it.

Mr. DOWNS. No; I think there are two flaws in the way it is now being run, both of which are now partly the result of the definition. One is that a great many people who are occupying 236 and 235 units are not people who are permanently with low incomes. They are people who are in a transition period in their lives and have low incomes. They are young people in school or people who are not the sort of permanently needy poor people who you would define as most in need, or average, over their entire lifetimes. Many of the units are now being occupied by graduate students and other couples who qualify legally but are occupying the units that I do not think Congress would primarily intend for them. Also, I think there is a tremendous amount of lying about income. I think the programs are being made to work more successfully than might appear (and partly, probably Mr. Emmer is referring to people who have slightly higher incomes than the limits) and this is being accomplished by falsifying income statements.

Our analysis indicates there is a tremendous amount of that going on, and that the certification programs are probably not very accurate. That may in fact be a very good thing.

Chairman PROXMIRE. It is too bad they cannot work with IRS to get accurate figures.

Mr. Emmer.

Mr. EMMER. I think I answered your question in my remarks. I do not feel that HUD has responded well. I think they have done a poor job and to those who would say, "Look at the great amount of housing production we have accomplished in the last couple of years," I really feel that was an ongoing and continuing program from earlier years.

As to the much more significant question asked of Mr. Downs just now: How can you solve some of the problems with the family? I think one of the biggest questions you have to face up to: Are you expecting low income, and very often, minority families to live where they want or where you think it is socially right for them to live? I think one of our problems is that there has been too much emphasis placed on dispersal without regards to the feelings of those being dispersed.

Chairman PROXMIRE. How about counseling, how about the performance of counseling? Let us start with Mr. Emmer. Has HUD done an adequate job there? Maybe it is not their fault. Maybe they have not had money from Congress, but in your view, have they done an adequate job with the money available?

Mr. EMMER. I do not think HUD has done anything to speak of. They made some past——

Chairman PROXMIRE. That is, counseling families who have never had experience with homeownership, for example, to work with them and advise them so they can do a responsible job and not suffer default.

Mr. EMMER. They started setting up a counseling program on a limited basis some years ago in the local FHA offices on counseling families where and how to buy a home, and the people I saw, limited to only two or three counselors, were not really skilled in the job and there was no question in my mind that they couldn't have done an adequate job of counseling; and I do not know if you know possibly how much it would cost to do an adequate job. We did it for 4 years, and it can be quite expensive.

Chairman PROXMIRE. Do you think it is practical to try that? We had a witness yesterday, Mr. Lawrence Katz, who did quite a job in Milwaukee and he said that counseling is one of the vital keys to it. They counsel very carefully there and they have no more money available than other big cities.

Mr. EMMER. I think it is not only practical, I think it is essential that we have a counseling program, and it has to cost less than the price of foreclosures.

Chairman PROXMIRE. Well, let me move along to some of these other things and get varying comments as I go along. If you would like to comment on what I have asked, go right ahead.

How about the argument about reasonably preventing defaults? Do you think they could have done a better job of administering the program? Of course, some of the defaults, Mr. Downs, I think you spoke to that to some extent, some of the defaults are going to happen. If you do not have any defaults it means you are not running the kind of program you should. You should take risks.

Like a banker who makes loans if there is not a bad one, occasionally he just isn't taking the chances he should. We will have Mayor Gribbs to testify very shortly, in Detroit where defaults have been very high.

Mr. DOWNS. Our analysis of this indicates that defaults were due to four basic conditions. One was the general neglect of the neighborhoods—and the general conditions of the neighborhoods—where the poverty households were concentrated together.

The second was unscrupulous private entrepreneurs who were buying houses and marketing and selling them at a high price with lots of needed repairs that people were not aware of.

The third was inadequate administration by HUD, including a complete failure to prepare most of the administrators of the program who had been working on suburban 203 units to encounter the different kind of inspection and other difficulties they are likely to encounter. Many people we talked to said they thought there was intent by some FHA officials to deliberately take a buyer-beware attitude because they

did not think the program was a proper one and they did not think it should work.

And then the fourth condition was the fact there were lots of low-income households among the new buyers who had never done this before and did not know how to go about buying a house and inspecting it. You put all those things together and you get a circumstance in which there are high defaults, although most of them were not under the section 235 and 236 programs.

Chairman PROXMIRE. You see, this latter thing you mentioned, one of the judgments that has to be made is to weed-out families. It is difficult to do it because there are families which just do not have the basic responsibility or the basic experience that would warrant making them homeowners. Mr. Katz said yesterday there are other things you can do with a family like that, you can provide a rent supplement, which you pointed out, and they can live in a rental unit, but just do not have the capability of swinging their own home.

Mr. DOWNS. The conditions are under conflicting objectives. On the other hand, take public housing where you are not allowed to screen-out destructive household. One of the reasons why the big urban public housing projects become mired in destruction and violence is court orders preventing the housing authorities from screening-out households they thought were destructive.

Chairman PROXMIRE. Of course, that is true. There is no question about the fact in some areas you cannot prevent it but there are other areas where you can exercise judgment in determining, for example, 235, who can have the responsibility.

How about training personnel? Would any of you gentleman like to continue on that, on whether or not they are doing an adequate job training personnel. Mr. Emmer.

Mr. EMMER. Senator, if I may just comment a little bit on the last point about qualifying people for the 235 program; first of all, I think although the records, indicate that 235 and 236 have not had a large number of foreclosures, I believe they will. The only reason they have not is because they are relatively new. As far as screening-out unqualified buyers we just found there was no way an accurate prediction could be made at the outset. We worked mostly in the 221(d)(2) program and for 4 years we did not have a single foreclosure because we spent what seemed to be our entire life working in counseling, while we were just the builder we helped collect for the mortgage lender just to preserve the integrity of the subdivision. In doing so, we used every method, including the threat of eviction.

I just do not believe there is an adequate way of making a judgment on a family's ability to own a home during initial interviews. So many of the problems we had came up because of family disaster; a marital breakup or a death, which took away a wage earner and because the families were not trained and did not know how to seek help in the method of conveying a home, and so what ended up happening they just did not know what to do and lost their homes.

Chairman PROXMIRE. But you had great success, you had great fortune in this.

Mr. EMMER. We had good success.

Chairman PROXMIRE. Your point is this could be done elsewhere.

Mr. EMMER. Yes, sir.

Chairman PROXMIRE. And if HUD could insist on this way of preventing default without seriously inhibiting the opportunity for the needy who are qualified to own their own homes.

Mr. EMMER. Yes, but it is a tough, difficult program and it takes dedicated people, not people interested in what grants they are going to get for doing it.

Second, I think you must take a very hard look at foreclosure procedures because of the case with which we could go to a family that is absolutely beyond hope and have them deed the house to us. In our 4-year record of not having any foreclosures one of the reasons for that was we took over a home which I only later learned was not quite the right thing to do. We had people sign deeds when they knew they could not keep their house. We told them it was for the benefit of their own future ability to buy a home or keep their credit good elsewhere, and we would find another buyer. We would come in, repaint and fix up the house at our own expense and have the new buyer move in and conveyed a deed to them, and it did not harm anybody.

These were $9,000 to $10,000 houses we sold at the beginning of our program, but instead of having a $3,000 cost to the Government, there was none. Instead, it used to cost me several hundred dollars. But this was a price I was willing to pay to keep a clean record at FHA. Instead of a foreclosure why not a family voluntarily signing a deed and avoiding vandalism and the kind of things that occurred?

Chairman PROXMIRE. My time is up. Mr. Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman. I want to say that I have had an opportunity to review the testimony of those I did not hear in person and find it most helpful.

Mr. Emmer, I share your thoughts about the problems of foreclosure. In fact, I have visited areas where houses have been abandoned, where the Government had no title in the house; because of the abandonment, vandalism destroyed them to such a state that they really could not be repaired again. This is highly destructive of the whole neighborhood, not just the house. Do you think we should change our procedures for the sale of these homes so that repossession and reacquisition of title could be simplified?

Mr. EMMER. Yes, sir; I think it would be relatively easy to do in many cases.

Representative BLACKBURN. You mentioned that Government policies are having the effect of increasing the cost of housing and even though we may agree with the overall purpose of these policies on that environmental impact statement, et cetera, we recognize they do increase the cost. What, in your opinion, has been the chief ingredient of increased cost in, say, the last 5 years?

Mr. EMMER. Just those things. For example, the way Davis-Bacon has been administered where it really was not the prevailing wage in some of our programs; it was the highest wage that anybody could find because—this is not meant to be any criticism of any particular group, organized labor was prepared to prove that the highest wages were the prevailing wages, and there was nobody to dispute that. It has been only recently some effort was made to reduce those prevailing wages. I am sure there was a time when they were important. Certain-

ly, the time does not exist now. I am equally sure no union man would agree with me.

Representative BLACKBURN. I frankly agree with you. We have made efforts to restrict the application of Davis-Bacon so that we could lower the cost of housing, but we have been unsuccessful because of political pressures being what they are in Congress.

Let me ask you this: Do you see any chance for lowering the cost of housing through improved technology, which you cannot use now because of either local building codes or perhaps restrictive union agreements?

Mr. EMMER. Well, basically, no. I really do not. Assuming that all wages and prices were stabilized, I really do not think that we could count on much of a reduction in costs because every time you figure out a way to save \$6 or \$8, a manufacturer will come along with something like a frost-free refrigerator or self-cleaning oven, which will cost \$30 or \$40 more. The operation breakthrough program which HUD has conducted the past several years is clear indication to me that prefabrication and other things they tried to accomplish in the industrialization of housing has not worked. When you analyze the reason for this it is quite clear to see that the cost of transporting the housing, the factory and set-up costs and the profit of an extra middle man more than offset the cost of any factory economies.

Representative BLACKBURN. In other words, having a market big enough to warrant the investment in plant.

Mr. EMMER. Yes.

Representative BLACKBURN. But then you have the problem of getting your units dispersed, and the cost of it raises the cost of distributing.

Do you have something you wish to say on that, Mr. Downs?

Mr. DOWNS. I agree with that. I do not think there is any significant cost savings for industrialized housing. I think countless studies by people who are informed have shown that to be the case and that the way to reduce the cost of housing is to reduce the quality of housing—that is, a mobile home is cheaper than a standard home, is smaller, is of less durable construction and requires less land. That is really the only way to reduce the cost of construction.

Now, you can reduce the cost of financing and reduce the cost of land. Those are different elements of costs. The cost of construction is actually only about one-third the cost of occupancy, if that. Sometimes it is less than that.

Representative BLACKBURN. You mean materials and labor that go into the structure itself?

Mr. DOWNS. That is right. When you put in land and financing costs and operating costs, they are the majority of the costs—more than the actual initial cost of construction. I think it is a myth to think that, if we industrialize housing somehow without reducing the quality in our new units, we are going to cut the costs very significantly. I do not think we are.

Representative BLACKBURN. Do you have any comment on that, Mr. Aaron?

Mr. AARON. Just that if somebody wanted to compile a history of the faith in cost reductions through the industrialization of housing

construction it would not start in 1968 or 1969. It would go back 30 or 40 or 50 years. For at least that long people have been writing inspired prose about the great cost savings of industrialized housing and been frustrated when they attempted to apply their inspired prose to real house construction.

Representative BLACKBURN. I am interested in the question of what do we do about court decisions and so forth that create problems in public housing? In Philadelphia, I believe something like one-third of the tenants there are in arrears on their rent, some of them have been in arrears more than 2 years. One of the problems is that they can go get free legal service to defend them in cases when they may not have a defense, but just by filing pleadings they can delay ultimate judgment. Then when they ultimately get a court decision the marshal is so far behind in his evictions that the public housing authority really does not have anything. The marshal advises him, "We are 2 years behind," and this in turn causes tenants who have been paying rent to say, "Gee, why should I pay, the guy down the hall is not paying." The combination of these influences along with the Brooke amendment have really been disastrous on public housing. We are facing a very serious threat of bankruptcy in public housing all across the United States. What is the solution to this problem? Should we give the public housing authorities more muscle, so to speak, to deal with tenants who are problem makers and do not cooperate?

Mr. DOWNS. Well, first of all, it seems to me you cannot expect a housing program—public housing—to solve the essential problems of poverty and destructive behavior.

The first problem is poverty. The Brooke amendment is really a welfare program. It is essentially an income maintenance program disguised as a housing program and administered by housing authorities in a way that destroys their ability to bargain with the tenants they have and exercise any influence over them. We recommended in our report that that program be abolished.

You are trying to use the public housing program to cope with the problem of poverty. When people have very low incomes, you are going to have a hard time putting them in a brand new housing unit—which a public housing unit is—and expecting them to pay for it. I think this is one of the delusions. We blame the public housing program for these difficulties, which really are of a different order of magnitude. If those people had higher incomes, then we would be much more able to get rents from them. If there were some kind of an income maintenance program that was paying them an income or if they had jobs, they would be in a position to pay the kind of rent that would make maintenance possible.

The destructive behavior problem is much more difficult and much more attackable. We could try to get the courts to recognize the consequences of concentrating such households in one place. But I really do not know what the answer to that question is; I think it is one of the most difficult problems in our whole society.

Mr. AARON. I think one answer to that may be avoiding the institutionalization of clusters of low income or problem families through the construction of large clumps of subsidized housing in

which one allows only low income people. One solution might be to allow a highly varied composition of the tenant population, as Anthony Downs suggested.

The difficulty with that solution is that it opens up housing subsidies to a very substantial fraction of the population. At present, roughly 1 to 30 percent of the entire population could qualify for subsidized housing on the basis of income eligibility standards under existing programs. If one goes further and relaxes standards even more, that percentage would rise.

The other approach is to award the subsidy to the individual or family rather than to tie it to a particular unit, thereby creating the possibility of some dispersal through individual choice. I suspect there will continue to be clustering to a very substantial degree but at least the Government will not have legally enforced it through the erection of monuments to homogeneity.

Mr. Downs. I think we could do what Mr. Aaron just suggested through the public housing leasing program because it is a housing loss, in essence.

Representative Blackburn. If we are subsidizing these families, it is either through a direct subsidy or through the landlord which may be public housing authority or rent subsidy through——

Mr. Downs. It can be. The public housing leasing program can be, as I believe it is in the Kansas City experiment, an allowance where you allow the household to go out and find the unit. You designate the household and say, "You are eligible for this allowance. You go out and find the unit and you can use it."

Representative Blackburn. Let me insert one thought here. We have been looking into the question of welfare and you mentioned, I think quite accurately, the Brooke amendment is a welfare program. We have developed a group of professional welfarists in this society who know more about the welfare laws and what could be obtained from various Government sources than I will ever know either as a lawyer or Congressman. They know the regulations and know the local personnel administering these programs, and, as I read one of the reports here, in the recertification of income, I see that some 8 percent of the families went off the 235 subsidy program. To me it is a very serious deficiency in that program that we do not have the subsidy allowance on a graduated scale so if a man earns a dollar more he loses 10 cents of his subsidy, if he earns another dollar he loses 20 cents of his subsidies, so that a man really has no incentive to work himself out of the subsidies.

As it is now we say, "If you make more than a certain maximum you lose the whole works," and people who look to these subsidies as income, whether it is the food stamps or aid to dependent children or what have you, they know better than anybody else what they can earn before they start losing these benefits, medicaid, or what have you.

Do any of you have any suggestions as to how we might realistically administer a subsidy program so that it would still retain an incentive in an individual to get ahead and not say well if you work another week this year you lose your money. I have had that happen, I have had employees say, "I cannot work the last week of this month. I earned too much this quarter, and I will lose certain programs." Do you have any suggestions to how we might do that?

Mr. DOWNS. May I point out that 235 and 236 already have the housing allowance feature built into them. One of the things we sort of admire about the 236 program is it is an ingenious combination of several different kinds of subsidies. As your income rises under 236, the amount of subsidy you get goes down gradually because a certain percentage of the subsidy is a difference between a certain percentage of your income and the income costs of the mortgage. That earn out feature that you are talking about already exists in both 235 and 236 once you are eligible. If you are not eligible, of course, you cannot get into it; but once you are eligible, that feature already exists in those programs.

Representative BLACKBURN. In other words, excuse me, my 10 minutes are up, in other words, if you can show you are, are below the maximum and that you qualify, you can increase your earnings above that figure?

Mr. DOWNS. And the subsidy declines gradually until you do not have any subsidy at all, yes.

Representative BLACKBURN. I see. My time is up.

Thank you, Mr. Chairman.

Chairman PROXMIRE. Mr. Downs, you made a most startling charge when you said some HUD bureaucrats deliberately adopted a buyer beware attitude on 235 mortgages because they did not believe in the program. Can you amplify this point? How widespread is this attitude? What is your basis for the charge?

Mr. DOWNS. I do not think the attitude is widespread now because I think there has been tremendous pressure on HUD bureaucrats. This is a kind of charge that is very difficult to substantiate. It is a hearsay kind of thing that our interviewers, when talking to people in regional offices of HUD, encountered among both developers and HUD members. They did not feel that this was a universal phenomenon among all the people in FHA. Rather, some of the FHA personnel felt that they were not very sympathetic with the program and they did not like it; therefore, they would administer it by sort of sticking directly to the rules without the use of the kind of cautions——

Chairman PROXMIRE. In your judgment, are we at a point where we should take steps to prevent this kind of thing?

Mr. DOWNS. I think the administration has already taken a tremendous number of steps to alter the way 235 is administered. In fact, as Phil points out, they have gone the other way. FHA is practically paralyzed with fear of being over-regulated, to the point that we understand in many offices they are over cautious now in making commitments. They have gone from one extreme to the other. I do not think the problem I mentioned is now a significant one.

Chairman PROXMIRE. Mr. Emmer, in your statement you say, "Local FHA and HUD offices are directed by political appointees. Many of them should not be there."

How extensive is this political patronage and is it relatively new in your experience?

To what extent is this at the heart of the mismanagement and scandals that have characterized HUD operations in recent years?

Mr. EMMER. I think in my experience, which is restricted to three offices in one State, it is total.

Chairman PROXMIRE. Total?

Mr. EMMER. Political appointees are in each of the three offices and have been under each administration whether Democratic or Republican.

Chairman PROXMIRE. Right; and in your view they have been to a considerable extent responsible for the lack of efficiency and the lack of an effective program, the waste?

Mr. EMMER. Well, I would say they certainly have not helped matters because a person who is trained in our business, and there are many good people who are, can certainly do a much better job with the programs.

Chairman PROXMIRE. Then you say it is total and continuing from what you can see?

Mr. EMMER. The last time——

Chairman PROXMIRE. You have not seen any changes.

Mr. Downs has remarked there were some changes in one of the other areas.

Mr. EMMER. Well, the last time there was a change in administration there was a change in the directors of those offices.

Chairman PROXMIRE. But the changes are like the old postmasters.

Mr. EMMER. Yes.

Chairman PROXMIRE. Always political, made sure we would never appoint anybody with any experience or competence in the Post Office, they usually had to be confirmed by the Senate and recommended by the appropriate Congressmen and the result was we often got incompetent postmasters.

Have you the same thing with the HUD offices?

Mr. EMMER. If I answer that question I will not be able to walk back into any FHA office.

Mr. DOWNS. I think you are putting him on the spot, Senator.

Chairman PROXMIRE. Mr. Downs and Mr. Aaron, you each provide in your testimony examples of the advantages and disadvantages of the housing allowance alternative and I think this may be considered as a new approach by the Congress this year. As you know, we have landmark legislation coming up. We did not pass a major housing bill last year and we are going to have to pass a housing bill.

You object, Mr. Downs, to the housing allowance because it would cause a sharp increase in the price of all existing housing units.

Mr. Aaron, you point out advantages of flexibility for the families involved, a dispersal of the concentrations of the poor from the inner city, and perhaps at a cheaper per unit price. Taking into account, I would like to get a little debate started between two of the most eminent authorities in the country, Mr. Aaron being perhaps the outstanding proponent and Mr. Downs being a principal and an outstanding, certainly, able opponent, so taking into accout the diverse objectives we are trying to meet through housing would you, Mr. Downs, list and specify all the disadvantages of the housing allowance and would you, Mr. Aaron, list the advantages and then we will prod each other.

Mr. DOWNS. Well, first of all, I would like to say I do not want to be put in the position of being a hundred percent opponent of a housing allowance.

Chairman PROXMIRE. I want to see you fellows debate and clash. I do not want to see you compromise. I want action.

Mr. DOWNS. I noticed that.

Mr. AARON. I think you are putting us into a falsely antagonistic position.

Chairman PROXMIRE. Then, let us get into a genuine antagonistic position.

Mr. DOWNS. Then we will be antagonistic toward you.

Chairman PROXMIRE. I think we can have a debate, understanding, of course, there are good points in the other's position and you do not take, neither one of you take, a dogmatic position. I am giving you that soft soap. Now go ahead.

Mr. DOWNS. I think the disadvantages of the housing allowance are the following. First, it claims to be equitable and to treat everyone the same, but when actually put into practice it does not. Because the cost of reaching equity—treating everyone the same—is quite large, the proponents of the allowance, including Mr. Aaron, usually immediately start showing how you can reduce the cost by dropping off certain groups, thereby reducing the equity. So that first claim that is made for it—that it is more equitable than the present subsidy programs, which are inequitable if they treat different people differently—is certainly not correct. That first claim usually is not substantiated.

The second claim made for it is that it would be cheaper per unit. I would agree if you take all people who are supposedly eligible by what I call a financial need view of housing. Most of the people who are eligible for housing assistance on a pure income basis are already living in good housing. That brings us to a third disadvantage I will come back to in a minute.

The second one is that it is cheaper than the present programs. It is cheaper only if you start to restrict the eligibility again or if you make the per household amount so low that we cannot allow any people who are subsidized to live in new units. I think there are so many real advantages in having some people who are subsidized live in new units—not everybody, but some.

The third disadvantage is that it really is not a housing program at all. It is an income maintenance program. Almost all of the money spent on the housing allowance would in effect not be spent for housing. In essence, it would be a general addition to the income of the people concerned. Now, since poverty is a principal cause of what is known as the housing problem, this could be viewed as an advantage to the program—that it is an income maintenance program. I am not necessarily opposed to it for that reason, but I think we should recognize it for what it is. Most of the people who would get a housing allowance would not improve their housing; or if they did, it would be by a small fraction of the size of the allowance they got. Most of the people who got the money would use most of the money for things other than housing. So, we are not really talking about a housing program in the same sense as in the construction subsidy.

The last disadvantage of significance is that it would tend to escalate the price of housing in those areas where it would be used on a massive basis. Now, that is a questionable—we do not know what

would happen if housing allowances applied on a large scale. I think Henry is right. I think it would result in a supply response, ultimately, but the mechanism of supply response——

Chairman PROXMIRE. Be as specific as you can, Mr. Downs. I think this generalization is probably correct. I do not know how you can resist it. but can you give us any hard evidence or any estimate as to how it would escalate the costs of housing?

Mr. DOWNS. Well, the most interesting evidence is the impact of welfare rent allowances, which did not seem to produce very high quality housing for people on welfare. When they have been raised, however, they have generally been accompanied by an increase in the price charged people in the neighborhood. Bernie Freed, of MIT, has investigated welfare rent allowances and cited that experience as an argument against the housing allowance.

The Urban Institute has estimated that, I think it is, 10 percent of the money spent on a housing allowance will be an increase in the price of housing. I believe that is a correct statement of their position, although I am not sure. I could not give you a quantitative statement. Look at medicare and medicaid, though, where we pumped a whole lot of money into the demand side of the market without expanding the supply side commensurately. We got a tremendous increase in price.

Chairman PROXMIRE. Well, I voted for medicare and medicaid and I would again, but I think you are absolutely right, it has been the most inflationary kind of program but while it enormously inflated the health costs, I think the equity was worth it.

Mr. DOWNS. At the same time you expand the demand, which I am in favor of doing, you should also expand the supply. Then you combine the two kinds of problems and sort of orchestrate them in a way that meets the needs of most housing markets. That would be my suggestion. I am not opposed to a housing allowance totally, but it has to be looked at in light of those disadvantages I mentioned.

Chairman PROXMIRE. Mr. Aaron.

Mr. AARON. I would like to begin by pointing out that the housing industry to a very considerable extent fits the economists definition of a competitive industry. There are many very small firms, the housing stock is owned in a widely dispersed manner, there are a lot of customers. It is an industry which firms can enter with some ease, and in which the supply of housing is quite elastic. Housing is however a very complex product, and it is hard for buyers to become expert. Studies have been done which would indicate that construction costs respond negligibly to increases in the rate of construction. In preparation for these hearings I tried to discover whether that was true and, as far as I could discover from some preliminary statistical analysis, it is true. So we are talking about a competitive industry, one in which the supply does respond to demand. To be sure, if there is an abrupt, huge increase in demand it will take time for supply to adjust. For that reason, I doubt whether large scale housing allowance scheme should be introduced abruptly. It would be desirable to introduce an allowance gradually.

I am prepared to defend the proposition that housing allowances would be more equitable in any reasonable timeframe than construc-

tion oriented subsidies. The existing programs provide only a trickle of new construction, even at the very much increased rates that have occurred in recent years.

At the end of the housing goal decade in 1978 there will be about 7 million subsidized units, less than 10 percent of the total housing stock for an eligible population equal to a quarter or 30 percent of the entire U.S. population. If we adhere solely to construction oriented subsidies, it will take two or three decades at current levels of construction to provide assistance to eligible households. Even the most cautious and gradual introduction of housing allowances could be completed far more promptly. Even if budgetary reality slows the process, we are talking not about a two- or three-decade transition, but a much shorter period of time.

Now, for the advantages of allowances. First, they enable all low income households to pay for better housing. Most deficient housing was acceptable when built. It has deteriorated because its occupants have not been able to pay enough to support maintenance and improvements. An allowance can help arrest decay of the existing stock. Second, allowances enable households to buy the kind of housing that best meets their needs. I argued in my prepared statement that a particular unit may be very desirable when a family moves into it. However, family circumstances change, places of employment change, children are born and leave home, housing may become less suitable as time passes; but a family may remain in its existing unit because the subsidy is available on that unit while none may be available for more suitable housing elsewhere. Even at the outset a family may take a subsidized unit that is not ideally suited to its needs, that is not as good as one it could obtain on its own if it could spend the subsidy as it chose. I have stressed in my prepared statement that housing allowances avoid inequities that are endemic in existing programs.

I am surprised at the contention that it is necessary to house subsidized families in new housing. New construction amounts to only 2–3 percent of the stock each year, and that means in a decade maybe a third of the housing stock will be new. Even if it is desirable to house some subsidized families, it is surely not necessary to house all, in new structures. It is not necessary to the reduction of racial or economic concentration of the population that they be housed in new units. If it is possible to provide allowances more quickly and more equitably than is possible under existing programs this would seem to outweigh the advantages of constructing new units.

One other thing about the nature of new housing which has not been mentioned and is all too often forgotten, much real housing improvement and construction does not show up in our statistics as new starts. It occurs each year in little bits and pieces as each new homeowner or property owner maintains and improves the property he owns. The great advantage of a housing allowance scheme is that it gets at the existing housing stock. Construction oriented subsidies may result in more newly constructed units—although the Swan study cited in my prepared statement raises some doubts—but does nothing for all other newly constructed and all existing housing units.

Now, the advantage of the housing allowance scheme is that it enables each household to maintain his house more adequately or to

bring to his landlord a larger amount of purchasing power with which to buy better housing. There is a good deal of evidence that profit on housing inhabited by low income families far from being exorbitant, as the conventional wisdom would have it, is really quite low, getting lower, and that property owners have been forced to scrimp on maintenance expenditures.

One of the reasons for decay is poverty and the inability of households to spend enough to sustain the quality of their residences. The chief argument, then, for housing allowances is precisely that it enables those poor households residing in existing housing, the vast majority of the housing stock, to pay for a higher level of services. In the kind of a market that the housing market is, a rather competitive market, it seems to me that allowances have a good chance of working.

In closing I want to support a basic and correct point that Anthony Downs made, that housing codes, zoning, and jurisdictional boundaries have contributed to the concentration of low income and problem families within rather constricted areas. It seems to me that is a separate problem. Existing housing programs show scant promise of reducing such concentration by themselves. Housing allowances may enable families to bid for and get housing outside neighborhoods of the poor.

Chairman PROXMIRE. Thank you, Mr. Aaron. Unfortunately, I wish this could continue, and we had time for rebuttal, we are not going to have any time for rebuttal. I wish you gentlemen would put in the record any rebuttal in correcting your remarks.

I cannot resist this final question and that is because on Thursday we have the distinguished Chairman of the Board of Governors of the Federal Reserve Board before us, Mr. Burns, and we have not had a word, word one, from you gentlemen or from any witness so far on what I have thought for a long time is the crux, the heart of the housing problem, certainly a big part of it, much of the housing problem, and that is the credit crunch that has slowed housing starts again and again, that pushed it into a depression in 1966, that has cut it back in previous years and may well do it in the coming year, a big fear on the part of housing people.

I would like to have each of you very briefly, and I apologize for stressing this but I have to do it, maybe in a minute or so, give us what you can, what policies you feel we should urge on the Federal Reserve Board, they are our creature, independent of the Executive, but they are not independent of the Congress, as to what we can do to have monetary policy that can cope with inflation and that would at the same time not demolish housing as it did in 1966 when, you know the story, a study by Maisel, which showed 70 percent of the cut back in inflation in 1966 was visited on three percent of the GNP represented by housing.

Mr. Aaron, will you start off?

Mr. AARON. I am very sympthetic with the plight of builders, other businessmen, and the families unable to find housing during a credit crunch. I do not know, however, of any evidence that the long run level of the housing stock has been materially affected by these credit crunches.

Chairman PROXMIRE. I understand that. Start and stop ruins the industry.

Mr. AARON. No, it does not, although it causes very severe dislocations, it hurts particular firms. But the construction industry is characterized by a large number of relatively small firms and ease of entry and exit. Although lagre fluctuations make life pretty darn miserable and wreak a a good deal of havoc on individuals and firms I know of no evidence that the credit crunch has had any perceptible impact on the total housing stock.

Chairman PROXMIRE. You cannot avoid increasing costs, can you, when you start and stop?

Mr. AARON. It has the effect of deferring construction from periods during which the credit crunch is severe to other periods when it is not.

Chairman PROXMIRE. It is inefficient to start an operation and have to cut it down drastically, and I mean drastically, cut it by two-thirds because of the shortage of money.

Mr. AARON. The constriction of construction, to use a couple of words that do not go very well together, during the period was nowhere near two-thirds, it was more on the order of one-third from previous——

Chairman PROXMIRE. It went down to less than a million housing starts in 1966 and now we are up to over 2 million.

Mr. AARON. Yes, but it was a decrease from about 1.3 to 1.4 million.

Chairman PROXMIRE. In some firms it is at least two-thirds, some 90 percent.

Mr. AARON. In some firms it is a hundred percent, they go out of business.

As for the impact on construction costs, I think I would defer to Mr. Emmer, but construction costs depend basically on the technology of the industry, the cost of labor, and the cost of materials, and although there are temporary bulges in such things as lumber prices, and probably temporary impacts on other costs as well from very substantial increases in housing construction, the basic point I am arguing only is that the total stock of housing has not been seriously affected by the credit crunch. I do not want to argue that it is desirable to focus all the burdens of adjustment on the housing sector. That is a questionable procedure on the grounds that it focuses the impact, the burdens of adjustment on a relatively small group of individuals, and that imposes hardship which probably ought to be spread more evenly throughout the economy.

I am making a much narrower point, that we probably do not have many fewer units today, or will not a couple of years from now, because of the crunches in 1966 and 1969, than we would have had if those crunched had never occurred.

Chairman PROXMIRE. Mr. Downs.

Mr. DOWNS. In the first place, I think we have changed the credit structure considerably since 1966. We have a lot of instruments that pump money into housing that were not operating then. In fact, in the last 2 years we have more money in housing than at any time in the history of the country, which is the principal reason why we have so many houses.

Chairman PROXMIRE. You have not had a crunch in the last 2 years either.

Mr. DOWNS. The production of houses is responsive more to the availability of money than it is to demand by the population wanting to live in housing. If builders can mortgage out, they will build a world with empty buildings, which they are now doing to some extent in some markets. I think that the mechanisms do exist to ameliorate the problem even if it comes up again.

In the second place, I think you have to look at it from the perspective of your overview as the Joint Economic Committee. What are the alternatives to having the housing industry bear the brunt? Who else would bear the brunt?

Chairman PROXMIRE. Business.

Mr. DOWNS. What kind of business?

Chairman PROXMIRE. Small corporations, business generally. Well, to have 3 percent of the economy bearing 70 percent of the brunt just is not fair, it is not right. It is not the way to operate.

Mr. DOWNS. Six percent of the economy is unemployed and bearing the brunt of having stable prices for the other 94 percent. We do not seem to be able to do much about that.

Chairman PROXMIRE. What is that again?

Mr. DOWNS. Six percent of the economy is unemployed, and they are bearing the brunt for the other 94 percent.

Chairman PROXMIRE. Of course, I have done my best to lead the fight against that sort of thing.

Mr. DOWNS. But what is the alternative?

Chairman PROXMIRE. But I am talking about the situation when the credit crunch comes. We had low unemployment as you had in 1966 and 1970 and then you have monetary policy used to try to dampen down inflation. There is no question when you have ample unemployment, lots of unemployment, ample availability of labor resources that you do not put the squeeze on.

Mr. DOWNS. Determining what is the matter with this arrangement is easy, and I agree with you. Determining the alternative arrangement is that will in fact arrive at the conclusion you want, which is to spread the burden, is not so easy. I do not know what an alternative arrangement is.

Chairman PROXMIRE. Well, the mechanism used in other countries where you give a priority to housing——

Mr. DOWNS. Yes, although——

Chairman PROXMIRE (continuing). That the European countries, other free economies, do that.

Mr. DOWNS. One judgment that has been made is that housing is a kind of need for which satisfaction can be deferred since most people are already living in good housing. This is true, and I agree with Henry Aaron that this has not really harmed the housing production capacity of the country as a whole. It certainly harms people who are in the industry; it kills them.

Chairman PROXMIRE. I sure asked the wrong two fellows that question. [Laughter.]

Mr. Downs. Sometimes it hurts to have objective witnesses on the stand. [Laughter.]

Mr. Emmer. I have always thought that the answer to the problem of having tight money periods could be cured by our national policy. I have always thought it was the Executive and Congress that made those policies. I would certainly be happy to see you level out the bumps we have.

Mr. Aaron says these things are really not very painful but I have got to say for those of us on the firing line, it hurts like the devil. I would like to give you one example of what happens; it has happened time and again, and I think you have to recognize it.

I have read several articles in magazines and newspapers recently about the defective housing being built, by large and responsible builders in various parts of the country, and largely these problems, where true, are due to the quality of personnel we can hire. When we advertise for help, all to often our responses are mainly from untrained people—hippies—as my hardhats call them. The point I am making is that each time there is a drop off in housing production, people leave the field never to return. They become salesmen, go to school, become lawyers, get on the police force, drive cabs, do all sorts of other things but they do not come back to the building industry with its ups and downs of employment. So when we start building again we grab out for anybody we can and we do take people who might otherwise be the unemployables. So this does have to result in an increase in costs.

Senator, I would like to take issue with one point you have made because I hear too much talk about it. You mentioned that housing policies in Europe may be better than ours. While this is not essential in anything you want to develop in these hearings, I have got to tell you that during my trips to Europe, I could not notice that their housing is comparable to ours in either quality or abundance. This, in spite of their attempts to put so much of their energies in housing production.

Chairman Proxmire. I agree with that. The only point I do make is they do insulate it from the credit crunch. As I understand it would have a serious effect on the cost of your operations if one year you have a hundred homes and the next year you have 1,200 instead of around 500 or 600.

Mr. Emmer. Of course, and both are bad.

Chairman Proxmire. Does that not make sense?

Mr. Emmer. Yes, both are bad. You can't win the battle. When housing starts to drop off you lose your qualified employees.

Chairman Proxmire. As compared to a relatively stable operation.

Mr. Emmer. Right.

Chairman Proxmire. So what I am talking about is not having housing bear none of the brunt but instead of bearing 70 percent of the brunt let it bear 4, 5, or 10 times as much as the rest of the economy, but not such an overwhelming, disproportionate share of it.

Well, gentlemen, I do apologize, Mr. Blackburn, of course, if he has questions of you he does want to pursue them, go ahead, but we

do have Mayor Bribbs and he has to leave unfortunately, at an early hour.

Representative BLACKBURN. Thank you very much; but I have no further questions.

Chairman PROXMIRE. Thank you very much.

(The following letter was subsequently supplied for the record by Mr. Aaron:)

THE BROOKINGS INSTITUTION,
Washington, D.C., January 2, 1973.

Senator WILLIAM PROXMIRE,
New Senate Office Building,
Washington, D.C.

DEAR SENATOR PROXMIRE: Because my oral reply to your question about the pros and cons of housing allowances rambled, this note presents the issues in brief outline form. I think each proposition can be sustained; Tony Downs did not rebut any.

1. Housing allowances would provide assistance to all families eligible on the basis of income. Present programs now and for many years will reach only a small fraction of those eligible.

2. Housing allowances help most those who are poorest. Present programs are less fair because they help most those who can afford sizeable required outlays.

3. Housing allowances permit recipients to buy the mix of housing services in the location they desire. Existing programs deny beneficiaries this freedom. This problem grows worse as time passes, family needs change and neighborhoods evolve; it reduces the efficiency of existing programs.

4. Most bad housing was not built that way; it deteriorated. Housing allowances would support increased outlays for maintenance of the existing housing stock. Existing programs do nothing to prevent adequate existing units from becoming deficient in future years.

5. Housing allowances would reduce the federal role in site selection; present programs put HUD in a political no-win position at the center of disputes between those who favor and those who oppose economic and racial integration.

6. At the same time housing allowances would promote dispersion by giving the poor the capacity to live in neighborhoods they now cannot afford, but in which, surveys suggest, they would like to reside.

7. Housing allowances are not "just another welfare program," just as Medicaid is not just another welfare program; they both channel demand. The implicit tax rates in current housing programs inhibit work incentives far more than would well-designed housing allowances.

8. Housing allowances would not materially increase housing costs if introduced gradually. The change in demand in virtually all housing markets would be small compared with typical year-to-year increases in demand. The best way of keeping vacancies high enough to forestall price effects is to assure ample housing credit and high aggregate production.

I hope that these arguments will be helpful to you in determining your own position. I only regret not presenting them to you earlier "in short form."

Sincerely yours,

HENRY AARON, *Senior Fellow.*

Chairman PROXMIRE. We are delighted to have with us the major of one of the great cities of our country, a distinguished mayor and outstanding gentleman who has testified before this committee a relatively short time ago.

Mayor GRIBBS. Yes, sir; and we are grateful for the results, Senator.

Chairman PROXMIRE. Unfortunately, Mayor Gribbs, I cannot take credit for giving you revenue sharing. I voted against it. I was one of a small minority who felt we could not afford to share the deficit with you.

Please proceed, Mayor Gribbs.

STATEMENT OF HON. ROMAN S. GRIBBS, MAYOR, CITY OF DETROIT, MICH., ACCOMPANIED BY WILLIAM M. NUGENT, SPECIAL ASSISTANT TO THE MAYOR; DAVID GARRISON, LEGISLATIVE COUNSEL, NATIONAL LEAGUE OF CITIES; AND HOMER HALL, DEPUTY DIRECTOR, COMMISSION ON COMMUNITY DEVELOPMENT, CITY OF DETROIT

Mayor GRIBBS. Well, I am sorry we are starting with that point. Senator, I have with me on my left Mr. Homer Hall, who is the deputy director of the Commission on Community Development for the City of Detroit; and on my right Mr. Garrison, who is legislative counsel for the National League of Cities, and Mr. Nugent, who is the representative of the city of Detroit, here in Washington.

Chairman PROXMIRE. You handle your statement any way you wish. I apologize, it is a short statement but we would like time to have questions.

Mayor GRIBBS. I apologize for being late but it was not my fault. I am pleased to have the opportunity to make a brief statement. I shall not be long.

Mr. Chairman and Congressman, the topic of Federal housing programs is of vital interest to me, not only as mayor of Detroit but as president of the National League of Cities.

I sincerely hope your deliberations result in a reasoned housing strategy and reasonable commitment to that strategy. I say that because I believe that the current Federal housing programs are frequently underfunded, and sometimes misdirected, and mismanaged.

I must view these shortcomings in terms of conditions as they exist in Detroit and in terms of the two paramount challenges we face—which are: The need to adequately house low-income families in our community and the looming crisis of conserving the housing units now in existence.

The need to adequately house low-income families is a problem of continuing importance—while the challenge of conservation is like a gigantic iceberg. What lies just below the surface will obviate any policy and program not designed to deal with the age and condition of our existing homes and apartments.

Detroit is a city of a million and a half people. Like most central cities, it has a high percentage of poor families. Over 11 percent of Detroit's families are defined as living in poverty by U.S. Census standards. Yet, only 2 percent of the population lives in public housing.

What is even worse, we can hardly afford the public housing we have now. In Detroit this year, we face a $4 million deficit in public housing operations. The limit on the contribution HUD could make according to their formula was $2.9 million—and they only had $2.2 million available.

In addition, we were constrained from raising rents—even if this recourse were advisable—by the provisions of the Brooke amendment. Even with this financial burden we must and do seek additional units of public housing.

I concur with your staff report on the section 23 leasing program as offering the best hope of providing those additional units of low-rent housing. It seems to provide an expeditious alternative to the expense, stigma, and impaction associated with large public housing developments.

I hope that a more extensive use of this program with respect to existing housing, can improve or at least contribute to the maintenance of our neighborhoods.

When it comes to Federal programs of interest subsidy for low- and moderate-income families (sections 235 and 236) I have less information but just as deep a concern. In both cases, I am convinced there is serious misdirection and mismanagement.

Too much of the interest subsidy dollars for owner-occupied housing goes for new construction and not nearly enough for rehabilitation of older housing. Until HUD began using 235 allocations for houses it owned as a result of foreclosure, used homes received an insignificant portion of the funds, although the same dollars might have adequately housed many more people.

Instead, the FHA pursued a policy of insuring and subsidizing "cracker boxes" on scattered small lots, often in bad locations. Many of these houses are now foreclosed and add to the blight of the neighborhoods.

The extent to which the 236 program for new or rehabilitated multiple dwellings may have been mismanaged is probably not fully apparent yet, but I do wish to comment on the general aim of the program as it has been carried out.

My impression is that the bulk of the funds available get spent on new construction in developing suburban areas. Furthermore, it would appear that by virtue of their location these subsidized units are not utilized by truly low- and moderate-income families whom the program is ostensibly intended to assist. Instead, the prime beneficiaries are more likely to be young families whose incomes are only temporarily limited.

While low-rent public housing and subsidized housing under section 235 and 236 are vital, the number of families affected by them is insignificant when compared with need.

By contrast, virtually all homeowners are affected by Federal income tax deductions related to homeownership, and many—if not most—by FHA mortgage insurance.

In Detroit, out of nearly 500,000 occupied dwelling units, 287,000 are single-family houses. Of these, 240,000 single-family houses are owner occupied. The rate of homeownership in the city is 60 percent—and black families in Detroit own homes very nearly in proportion to their percentage in the population of the city. Obviously, Detroit and its people have a real interest in programs to aid homeownership.

Because Detroit is fully developed and its homes and apartments are generally "middle-aged"—two-thirds built before 1940—Detroit also has a major stake in the challenge of conservation. Unfortunately, the Federal program which could have done so much for the housing needs of Detroit's poorer families—and for the conservation of housing—has boomeranged through mismanagement into a major threat to the health of neighborhood after neighborhood.

I am, of course, referring to the FHA foreclosure scandal. That scandal probably has adversely affected more housing units in the city since 1968 than have been built or rehabilitated under Federal subsidy programs since their inception over 30 years ago. We have reports of incompetent appraisals, insuring of homes in substandard condition, easy approvals which included grossly insufficient estimates of monthly maintenance costs—all from bureaucrats whose business is housing—and even reports of impropriety and corruption.

Now, HUD owns about 7,600 houses in the city of Detroit, with many more in default. An additional 2,000 houses have already been demolished because their condition was so bad when they came into HUD's possession that they could not be rehabilitated or they were vandalized while standing vacant. Of the current 7,600 HUD-owned homes, 3,400 are slated for demolition.

While FHA programs have indeed been mismanaged, I do not wish to suggest for a moment, gentlemen, that the programs be abandoned.

After the area office was established and William C. Whitbeck appointed director, the situation began to improve. A measure of responsiveness was added to what had been a most callous bureaucracy.

The city of Detroit was able to secure the cooperation of HUD/FHA in establishing city inspection of all homes for sale with FHA mortgage insurance—so that defaults stemming from substandard conditions existing at the time of sale could be averted. To our knowledge, we remain the only major city in the country to have established such a program—one which I feel is a model worthy of national attention.

Our success with the program of inspection is evidence of the tremendous potential for positive impact under proper management.

Turning from programs as they exist, let me address the question of what can be done in the future. I especially wish to address the challenge of conservation.

First, I wish to express my gratitude for the attention devoted to housing programs by so prestigious a body as the Joint Economic Committee of Congress—by these hearings and by the fine staff documents prepared and made available to us.

Second, in that regard, the report prepared by Mr. Henry Aaron entitled "Federal Housing Subsidies," makes a fundamental point which I wish to emphasize: That we have no consistent housing strategy. Instead, Mr. Aaron says legislation has been proposed, debated, amended, and enacted piece by piece.

These are strong words, but I think the very nature of the issues raised by this committee suggests a certain validity—and, I hope, the desire to see that situation corrected.

In the absence of a consistent national strategy for housing, what we in Detroit see happening is what your staff documents refer to as "filtering." We need to look again at how this process works and what its impact on housing is.

As new subdivisions are built—now in the suburbs far from the central city—some of these new homes are occupied by families moving out of older homes. Over time, the older neighborhoods are inhabited by people of more limited means who, in turn, have their former neighborhoods occupied by families of even more limited means. As a result, expenditures for maintenance and modernization frequently are squeezed out.

The tragedy and the challenge is that house after house in neighborhood after neighborhood has been neglected for many years—necessitating major investment now and substantial expenditure on a continuing basis.

The dilemma I face as mayor is that I do not have the power or the resources to to see that major investment for maintenance and modernization occurs as it must if we are to avert a colossal housing crisis: nor does the city have the capacity to raise resources for maintenance and modernization on a continuing basis.

Therefore, I must look to the Federal Government and suggest that the enormous subsidy redounding from income tax deductions for homeowners and the pervasive influence of FHA and VA insurance programs can be harnessed and redirected to help meet the challenge of conservation.

First, redirecting or augmenting the subsidy represented by Federal income tax deductions relative to homeownership to aid and encourage maintenance and modernization should be given serious consideration. Your staff documents note the strength of the incentive and the size of the subsidy represented by existing tax deductions—which I believe is double the amount for all other housing subsidy programs combined. Given the challenge of conservation we face, the purpose of these deductions must be reexamined.

Second, the power of the Federal Government and the influence of FHA should be harnessed to assure that investment in maintenance and modernization of housing is foremost in the consumer's mind.

With regard to FHA, I would urge the Congress to consider making available subsidized home improvement loans for major housing maintenance and modernization throughout older urban areas. At the very least, presently subsidized loans and grants must be drastically increased. Such loans and grants are available now only in HUD-assisted project areas and they should be citywide.

The Congress should consider a massive program of education and counseling through FHA with heavy emphasis on maintenance and modernization.

The FHA must see that mortage insurance application estimates of maintenance reflect the true cost.

The Congress should even consider means through the vehicle of mortgage financing to see that funds are available on a continuing basis for maintenance and modernization. Over a year ago I began to suggest the idea of an escrow account for this purpose. The escrow could help insure funds where available through monthly deposits into an account which could pay interest and provide a management fee for the mortgage banker. I still believe it is worth exploring.

Let me point out that there is a vital link between Federal housing programs and special revenue sharing programs—and in the absence of that, adequately funded categorical programs such as urban renewal, code enforcement, and the neighborhood development program. These categorical programs provide the necessary tools to make Federal housing programs work—by providing the potential for the creation or reconstruction of the proper urban environment.

In summary, Mr. Chairman, I again wish to express my gratitude for the attention you are devoting to these issues and the opportunity

to offer my observations. I hope that these hearings can result in a coherent national housing strategy and a realistic commitment to that strategy.

For us in Detroit and for much of the Nation that means:

Adequate funding of low rent public housing programs;

A greater allocation of interest subsidy dollars to existing houses and older neighborhoods; and

A series of actions designed to meet the challenge of conservation by providing for a massive investment now and insuring continuing attention to maintenance and modernization from now on. What is at stake is nothing less than the confidence of citizens in their Government.

I thank you, Mr. Chairman.

Chairman PROXMIRE. Thank you, Mayor Gribbs.

Let me just ask you the $64 question first. Detroit is one of the great cities in this country. You had a series of good mayors, including yourself.

Mayor GRIBBS. Thank you, sir.

Chairman PROXMIRE. You had the help of one of the most progressive unions in the United States, I am talking, of course, of the UAW under the leadership of Walter Reuther and Leonard Woodcock. You are the center of the automobile industry which has been in the forefront of responsible industry in the Nation. You have a good police force, well trained and fair, and you have had one of the major urban renewal programs in the country.

Why is it, with all of these hearings, advantages which a number of cities do not have, that in Detroit HUD has the worst record of housing defaults that they have in any major city in the country?

Mayor GRIBBS. I would remind you, sir, that program is under the Federal Government.

Chairman PROXMIRE. Oh, yes, indeed. I was going to say this is not an indictment of Mayor Gribbs.

Mayor GRIBBS. I just want to make it very clear it is a matter of mismanagement as I indicated in my remarks.

Time after time good solid older neighborhoods fall victim block by block——

Chairman PROXMIRE. Let me just say when I talked about good mayors I included you, I made it with that emphasis, I included you, you are in the best position to see this as mayor, it affects you directly and you are so close to this program I would like to get your observations as to how they mismanaged and why?

Mayor GRIBBS. There were many reasons; in fact the grand juries now are ferreting out the reasons. The handling of the programs, primarily the 221's brought about the problem we have now. It started with the fact the houses were over-appraised and the latest is that on the first of this month, the grand jury in Detroit handed down another series of indictments, I believe eight, four of whom were officials of the local HUD agency.

In addition to that, the houses were not properly inspected. Persons were allowed to buy the homes who did not have the capacity to maintain them. Even if they did going in, within a few months the major repairs that were required caused them to abandon the homes

because they just could not afford them. They stayed in the houses until they were evicted, letting the house deteriorate further. By the time the foreclosure process was completed the house had stood vacant and often been vandalized. Then HUD ends up with these huge numbers of dilapidated and vandalized houses that have to be demolished and until they are demolished, which takes money and processing, they stand there and the whole neighborhood suffers. So it is a management, or mismanagement, problem, Senator.

Chairman PROXMIRE. Would you say that political appointees who were not qualified and not competent are one of the reasons for this?

Mayor GRIBBS. No, I would not. I would ask you to reflect upon the fact that Mr. Whitbeck is a political appointee, and since he has arrived as area director things have improved. Those persons who have been indicted, and many who seem to have been responsible for mismanagement and poor judgment are bureaucrats—civil servants, I assume—and not political appointees.

Chairman PROXMIRE. How would you recommend to improve the situation?

Mayor GRIBBS. I think the whole operation has to be tightened up. Those who are on the firing line indicate that the system initially was not carefully monitored. Mr. Whitbeck indicates he is understaffed. Those are the problems that have been related to us.

Chairman PROXMIRE. How long has Mr. Whitbeck been in this position?

Mayor GRIBBS. About 2½ years, that was when the area office was established in Detroit. Before that the FHA had an office there but the rest of the HUD operation came later.

Chairman PROXMIRE. I do not know whether this would apply to the Detroit office, I heard perhaps one witness say HUD is not understaffed, it is underdirected.

Mayor GRIBBS. Yes, I think that is part of it. I think there is no one answer to the problem that HUD is experiencing now and to the problem that has been inflicted on the city by HUD.

Chairman PROXMIRE As you know, in any management there is no substitute for getting experienced, capable, responsible people who will work hard at the job and have the background that qualifies them to do it, No. 1; and then, No. 2, certainly there should be training of the personnel involved so that appraisals can be responsible and accurate. There should be monitoring to see there is no corruption, which I guess there was in some cases here. You have indictments, but also so there is no mistake made on the basis of honest inability to make proper appraisals. Apparently that was all lacking in this operation.

Mayor GRIBBS. That would be my judgment.

Chairman PROXMIRE. How about the counseling of the——

Mayor GRIBBS. Counseling of the homeowners only began about 8 months ago and it is minimal at the moment.

Chairman PROXMIRE. Is this not an area which should be greatly increased?

Mayor GRIBBS. Yes, indeed.

Chairman PROXMIRE. Would that not be helpful in having people make sure when they come in what the responsibilities are?

Mayor GRIBBS. Indeed, the combination of counseling, good and fair appraisals, and pre-inspection—which is 100 percent as far as HUD is concerned—will give homebuyers a better chance. At the moment the city is doing the inspections. We are pleased to have instituted this program some 8 months ago to assure that houses do not fall apart because of conditions existing at the date of sale. But there is still a great need for counseling, for better appraisals, and, at the moment, for recovery of those houses that were sold during the past 3 years and are now standing abandoned and deteriorating. Every day they stand they harm the houses next to them and the whole neighborhood. They become a crime problem because they attract drug users and vagrants. Because of these kinds of conditions, it is—as I have said on many occasions—just where HUD is supposed to be part of the solution that it became part of the problem in the city of Detroit.

Chairman PROXMIRE. Do you or your assistant have any record of what happened in the last 3 or 4 years or more in defaults and foreclosures by HUD, takeovers by HUD?

Mayor GRIBBS. Yes.

Chairman PROXMIRE. Do you have that available?

Mayor GRIBBS. We do not have it. We have some round numbers—45,000 sales and roughly 10,000 in default; in takeovers, it is almost one out of four.

Chairman PROXMIRE. One out of four. Is HUD getting on top of this problem now, in your opinion?

Mayor GRIBBS. Yes; they are improving. They had a task force of about 250 people come in around 8 months ago to help determine what was going on at the moment. They assisted in establishing some remedial steps, such as counseling persons who have missed one or two payments, to make them aware of the consequences when the third one arose, and hopefully prevent default. Coupled with some of the other practices that had been instituted, the situation is improving. But the problem still exists and it is gigantic in terms of numbers.

Chairman PROXMIRE. One of the things that troubles me a lot, Mayor, is Detroit has had a great deal of urban renewal, more than most cities it seems to me, most of it before you became mayor, was used for luxury apartments, an industrial center, and, I believe, an athletic field for Wayne University.

Is it true that very little housing for poor people was built on your urban renewal land? I want to know whether it was a mistake and whether that is being changed?

Mayor GRIBBS. At the moment, the land that is available is being used a great deal for housing, including a large number of 236's. The urban renewal program had to be changed or at least the purposes of given areas had to shift depending upon the market and the demand.

I guess the sum and substance of an appraisal of urban renewal would be a mixed reaction—some successes and some failures—again for many reasons.

Chairman PROXMIRE. I was talking about requiring or about putting far more of this into residential properties that could be available for the people with low and moderate incomes. It was my understanding that the whole point of the slum clearance program was to clear out the blighted areas and replace them with housing which people with low

and moderate incomes could occupy. Instead, we have had, as I say, luxury apartments and athletic fields and so on.

Mayor GRIBBS. This goes back many years. Even in the last few years before I took office, there was an increase in low and middle income housing development, adjacent to that high income housing you spoke of. Also, there is a great deal of the land being used now for senior citizens housing.

We tried to include in our total city planning the use of the land that has been made available by urban renewal to combine new residential properties and more properties for commercial and industrial growth, because that is necessary for a well-balanced city. Detroit is an old city, and a large city—fifth largest in the country—and we are talking about rebuilding the core segment of that city.

Chairman PROXMIRE. Well, you talk repeatedly, and I thought very eloquently, about conservation in your statement. I understand that HUD is razing several thousand of the 11,000 residential properties which they required. Is there any Federal, State or local program of redevelopment of some large acreages of vacant land?

Mayor GRIBBS. No. The vacant land resulting from foreclosure is generally scattered. In addition, the city cannot afford more than her share for current Federal projects but the State of Michigan has a housing development authority which is seeking larger funding. They are seeking $500-million authority in bonding provision, and they hope to be more active in the city. They have built a few buildings in Detroit and they have a few rehab projects underway but they are minimal compared to our needs.

We are considering some redevelopment but I would like to stress again the point, Senator—and I think I speak for many cities, older central cities—when I say that the area of conservation is hardly even being touched. I believe that this is the major problem because the housing is sound but, as I indicated, it goes from hand to hand into lower-income families with lower capacities for maintenance. With subsidization, in a relatively small amount compared to the cost of providing new housing, we can maintain and extend the life of units and provide good housing for more low- and moderate-income people, based upon the houses that we do have, that can be repaired and modernized.

Chairman PROXMIRE. Let me ask you, could you not get the concentrated code enforcement program extended to almost all the decaying parts of the city and thus get loans and grants for older dwelling maintenance as you ask for in your statement?

Mayor GRIBBS. I would like to have it citywide but now it is limited to project areas that HUD approves.

Mr. Garrison indicates there is no HUD money to be spent on that program at all.

Chairman PROXMIRE. Let me ask you before I yield to Mr. Blackburn, what do you think of that project?

Mayor GRIBBS. I favor it. I think it should be continued. I think it is the best answer: code enforcement, modernization, loans and grants to allow the people who live in older houses improve and maintain them and not let them continually go downhill. I think that is an area that Congress must give attention to.

Chairman PROXMIRE. What reason did HUD give for not funding it?

Mayor GRIBBS. Lack of funds, isn't that what they always say, Mr. Garrison?

Mr. GARRISON. Yes. The decision was made apparently over a year ago not to spend any money this year on code enforcement activities as part of the title I urban renewal budget that HUD receives each year from the Congress. Many cities, including Detroit, are going to be very seriously hurt by that decision as, in addition, they are going to be hurt by the decision not to spend the full amount of money that Congress appropriated for the section 312.

Chairman PROXMIRE. Is that not a wasteful decision just in terms of strict economy?

Mr. GARRISON. Yes, sir; it is particularly in the case of cities such as Detroit which have ongoing code enforcement staffs and the decision to cut back on the Federal money means they have to cut back on local efforts.

Chairman PROXMIRE. Here a decision, superficial decision, to cut back on spending in the short run. Result: a whale of an increase in cost to the Federal, city, and local government.

The other question I wanted to ask you was about the model cities approach to bring together social services, employment, housing rehabilitation and so forth, has that got merit?

Mayor GRIBBS. Yes, sir; I favor the program and extension of the program. It is, in terms of history, just getting underway and it has served many beneficial purposes in the city of Detroit.

Chairman PROXMIRE. Mr. Blackburn.

Representative BLACKBURN. Thank you, Mr. Chairman.

Mr. Mayor, I share your concern about the failure to really take advantage of the existing stock of housing; and I have been in cities, thought I have not visited your city, where the problem is really acute. It is really distressing to see houses that are maybe 40 years old but still very substantial homes, better-built homes, perhaps, as far as material and workmanship are concerned, than the houses we are building today, and yet to find one-third of the housing on the street completely abandoned, perhaps a good percentage of them vandalized and an occasional house burned because the owner may have found it more convenient to burn it and collect the insurance than to try to put it on the open market.

Now, certainly, we are all aware that it is more than just a matter of structure. If it were just a matter of structure we could say we are going to spend x dollars on that house and repaint it and refurbish it. But we have an overall problem too, of the location of the house, the environment of that location, the desirability or lock of desirability of substantial persons to want to move into that neighborhood even if the home were refurbished.

What do you suggest that we do aside from just the physical plan, trying to refurbish a home, of trying to make a neighborhood more livable? It is a people problem as well as a housing problem.

Mayor GRIBBS. Of course, in the final analysis it is. But people, because of their economic level, are thrust into circumstances and neighborhoods over which they have no control. There are many

good neighborhoods in the city where you can see that the homes are 40, 50, 60 years old, but they are repainted, the lawns are meticulously well-kept, and the total environment is healthy. Is is a neighborhood in which you have no trouble keeping people.

By the same token, you can put one rotten apply in the barrel and then the whole neighborhood just starts to deteriorate. And to maintain the health of a city as a whole, we have to approach each problem.

I think the devastating problem that we have at the moment is the fact that so many houses are abandoned. As a matter of fact, in an effort to remove these abandoned houses quickly, I have allocated, and my council has approved, $2½ million of unanticipated revenue sharing we received—thank goodness for that—solely for the demolition of homes in the city of Detroit, to tear them down quickly and keep the blight and deterioration from spreading.

But in addition to the housing problem, Congressman, you have the crime fight. I have to say with, I think, justifiable pride, that we in Detroit, the citizens there, have been doing very well to help themselves. With the help of the very severe taxes that we have imposed upon ourselves, we have increased our fight against crime and the crime rate has fallen for 2 years in a row. This year it has been down 15 percent from last year. We have improved our community programs. I think there is an increase in the understanding of the citizens and of their confidence in the city. We have the largest building boom in our downtown area that we ever had in the history of the city of Detroit.

So the city is starting to go back uphill: it is pulling hard together and the citizens are doing everything they can. It is the problems imposed upon us by the Federal Government, the nationwide problems, that are among our major problems. The housing problem that we have in Detroit now is exacerbated by Federal policies.

Another major problem is the city's unemployment. Our unemployment rate did not go below 9 percent for 18 straight months until last month—did not go below 9 percent for a city of a million and a half people—and last month it was 8.2 percent. Before that it was 9, 10, 11, 12, in fact, 13 percent in the months before that.

Representative BLACKBURN. To what policies do you attribute that?

Mayor GRIBBS. Beg pardon?

Representative BLACKBURN. To what Federal unemployment policies?

Mayor GRIBBS. I say unemployment is a Federal problem and inflation is a problem controllable by the Federal Government and Congress. What I am simply putting in context is that the citizens of Detroit are doing all they can and doing well in rebuilding the city. Our major concerns and major falling backward are imposed upon us by national activity and not local activity.

Representative BLACKBURN. Well, of course, you welcome the national dollars to solve your local problems.

Mayor GRIBBS. Indeed.

Representative BLACKBURN. And yet you blame your problems on the National Government. I think you——

Mayor GRIBBS. Only in part.

Representative BLACKBURN (continuing). Cast too much of the burden upon us in the National Government and I wish it were as easy as you apparently feel it is for us to control inflation here or to improve employment or whatever. We can affect, we can stimulate the economy, we can sometimes damage the economy but as far as Government being able to control our economy, I certainly hope we never move into that realm. If we do our whole economic system is going to be in danger. So, do not give us too much credit or too much blame for the national problems that we face.

Well, thank you for your time, Mr. Mayor. I find——

Mayor GRIBBS. I intended, excuse me, Congressman, mostly to point them out without a solution that I necessarily have or one that is——

Representative BLACKBURN. Now, in your crime problem, have you become quite stern in enforcing the law? You have beefed up your police force, for example, and you are taking the criminals off the streets. Is that a solution to it or one of the solutions to the crime problem?

Mayor GRIBBS. Many steps, I think, can be attributed to the crime job. For one thing we did beef up the police department. We had a force of 6,000 police officers: we have added about 600 in the last 2 years. We have concentrated efforts in professionalizing the police department. We are integrating the police department more effectively. As you may know, 44 percent of our population is black, and we have doubled our efforts to add black police officers. We have promoted black men to police officers and, as a result, we have more respect for the police department, more cooperation with the people.

We have been able to modernize police techniques. We have a new communication system. We have an air patrol. Many facets have added to this effort, but the principal one is that we have been successful in building more respect for the police department and because the citizens are cooperating and we are helping to reduce crime.

Representative BLACKBURN. I think that is really a very important key to the problem of the cities, in that people are not going to live in circumstances where they feel insecure for their own safety or for the safety of their families or their property, and if it means losing their homes and moving out and taking a terrific financial loss they will do that if they feel insecure. So, I certainly applaud your efforts in that direction, and wish you more success.

Mayor GRIBBS. Thank you.

Representative BLACKBURN. I have no further questions, Mr. Chairman. I have an appointment myself.

Chairman PROXMIRE. I do have a couple of questions for you, Mayor. Supposing you were Secretary of HUD and the President told you you were going to have to cut housing by 30 percent, housing expenditures, what would your priorities be? What would you say are the programs you must have, viewing this now as mayor of Detroit as well as Secretary of HUD? What do you think would be most useful for our cities?

Mayor GRIBBS. First of all Senator let me say that I would resign. It is an impossible job. But if you insist on an answer—conservation and low-income home maintenance programs. By conservation, I mean

code enforcement. modernization programs, neighborhood maintenance programs. Also continuation of urban renewal because that is vital.

Chairman PROXMIRE. What is that one again, the last one?

Mayor GRIBBS. Continuation of urban renewal because, again, it is vital as an effort to demolish those areas beyond assistance. Off the top of my head those would be the priorities, along with maintenance and expansion of low-income housing.

Chairman PROXMIRE. How about counseling?

Mayor GRIBBS. Oh, indeed, part and parcel of the program of HUD, yes.

Representative BLACKBURN. Let me insert a question here, Mr. Chairman.

Chairman PROXMIRE. Yes, sir.

Representative BLACKBURN. What would you suggest, you being in power, to do when a house is being vacated in a block? Let us take a house in a block where most of the homes are being used: One day you wake up and find a house that has been abandoned (you mentioned the problem of a rotten apple and I certainly agree with you) do you suggest the city be given the power of eminent domain to go in immediately and destroy it?

Mayor GRIBBS. Indeed.

Representative BLACKBURN. How would you take title to it?

Mayor GRIBBS. Well, of course, the legal process would have to be shortened, and it has recently been shortened in Michigan. The foreclosure process took a total of a year and it is now down to around 6 months, depending on the kind of mortgage. What I would like is to be able to take title immediately and then make the judgment to rehabilitate or to demolish. The expert would come in any say: "This is a sound structure and the cost of rehabbing is x dollars." If the house is worth that in that area and it can be done, then you rehab; otherwise you tear it down immediately and you have a vacant lot.

Representative BLACKBURN. Thank you. I appreciate your letting me ask a question.

Chairman PROXMIRE. This question I am going to ask you, I am just about through, but this question I am going to ask you for the mayor of the motor city it may be a little difficult for you to answer, and that is, I understand that the effect of the highways, the automobile, on Detroit has been devastating, very difficult. You have to use up so much of your space and so much of your revenue to provide for automobiles, the highways, the garages and all the other problems that go into it, that it has been one of the very, very serious problems in Detroit.

Mayor GRIBBS. No more a problem in Detroit than any other major city that has congestion problems.

Chairman PROXMIRE. That is true, that is why I asked you that question, the questions I am trying to frame would generally be applicable.

Mayor GRIBBS. It is a concern, but it is also a blessing. It is a means of commerce, of bringing business to the downtown area, and we need the access that the expressways provide. Incidentally, they are paid for by the Federal Government and the State, so we have no problem as far as maintaining the major access highways goes—we are trying

to stimulate business in the downtown area, provide more jobs and parking.

Chairman PROXMIRE. But there are lots of problems involved in freeways coming into a city.

Mayor GRIBBS. Indeed.

Chairman PROXMIRE. The Federal Government may build them and the State, 90 percent of the cost but it is no great benefit to the city of Detroit to have the impact that it must have on some of your neighborhoods, some of your residences, the crowding, congestion, all the other problems involved.

Mayor GRIBBS. I think what is necessary now is to make an accommodation so that the problems of the automobiles are minimized, such as adequate parking—not ground level parking, but deck parking.

Chairman PROXMIRE. How about what this does to your tax base?

Mayor GRIBBS. You see, it is very desirable, in fact essential, to the health of the city. We are in fact a financial center, and it is essential that the city maintain the business that keeps it alive. This is helped by the good transportation—water, air and ground transportation, in our location—the influx of business and commerce—the downtown building boom—provides the continuous taxes that provide the resources with which we can provide social services and other services that the citizens need.

Chairman PROXMIRE. But does not the impact of the highway program on your tax base, is that not a serious handicap?

Mayor GRIBBS. Yes, but it is one we have been living with for some time and I guess we are accustomed to not having the land that was taxable land that was replaced by the expressways.

I think that one of the areas in which the Federal Government is moving slowly and must move more rapidly, as must local areas, is the development of other modes of transportation. I think neither should be excluded, surface transit, nor expressway, nor mass transit in some form.

Chairman PROXMIRE. How about a commuter tax, do you have that?

Mayor GRIBBS. Yes, we do.

Chairman PROXMIRE. That is helpful——

Mayor GRIBBS. Yes.

Chairman PROXMIRE (continuing). For the people who use your highways and freeways.

Mayor GRIBBS. Not for transportation but those who work, I thought you were referring to the income tax.

Chairman PROXMIRE. People working in the city but who live outside are the ones using your highway system.

Mayor GRIBBS. Yes, it is not directly attached to the highway but the tax is applied to those who work within the city. We look forward to, we encourage in all ways possible, the construction of larger financial, commercial, and industrial facilities within the city because this is important. It provides jobs and it provides the tax base that we need to provide the resources.

Chairman PROXMIRE. Mayor, before you depart, I just want to say this, this is not in response to you but I have been in the Senate now for 15 years, I have been chairman of the committee off and on, we alternate with the House, it is a joint committee, as you know, Con-

gressman Patman and I share the chairmanship, I have it this year, next year it will be Congressman Patman, and I serve, of course, on other committees but I cannot recall any agency which has been more seriously or consistently or effectively indicted for its incompetence than HUD has been by the witnesses we have had to date in such a short time, and indicted on the basis of HUD's inability to administer a housing program efficiently, effectively, provide just the rudiments good appointments, people who have the capability of doing the job, of training their own personnel, of providing for the services where they are the most needed. It is a record of dismal failure.

Unfortunately, the Secretary of Housing and Urban Development, an outstanding man, a man who comes from Michigan, has declined to appear tomorrow, and he has declined to send up any representative, although we would have taken anybody, so this indictment must go unanswered. I think it is tragic but that is the case. I think it shows contempt of the Congress as well as an inability simply to answer the question as to what has gone wrong with HUD, why our housing program of the Nation is in such a tragic condition.

I say that because we scheduled hearings and we thought he would come up tomorrow and he declined after indicating that he would.

Without objection, I would like to place in the record correspondence with Mr. Charles G. Haynes, Inspector General, Department of Housing and Urban Development.

(The correspondence follows:)

CONGRESS OF THE UNITED STATES,
JOINT ECONOMIC COMMITTEE,
Washington, D.C., November 16, 1972.

MR. CHARLES G. HAYNES,
Inspector General, Department of Housing and Urban Development, Washington, D.C.

DEAR MR. HAYNES: This Committee will hold hearings on the economics of Federal housing programs December 4–7, 1972. Secretary Romney is expected to be one of the witnesses.

To help the Committee evaluate the economic design and operation of the programs, it is necessary to sort out those problems which can be and are being overcome through corrective actions and administrative oversight which are, I believe, primary responsibilities of your office. We are desirous of obtaining information that can be placed in the record so that the members of Congress will have a better understanding of past program experience and the outlook for the future. It would be appreciated, therefore, if you could provide the Committee, by November 30, with the following information:

1. The date of your appointment.
2. The number of people in your office at the time of your appointment, and at present, who are assigned to (a) investigations and (b) audit.
3. The number of HUD employees (a) reprimanded, (b) fired, or (c) indicted during 1968, 1969, 1970, 1971, and 1972 for improper activities in connection with the conduct of housing program business.
4. Describe the system of inspections of field office operations, if any, that you have instituted or modified since your appointment.
5. The number of routine inspections of HUD area and FHA insuring offices that were conducted one year prior to your appointment, that have been conducted since your appointment, and the nature of such inspections.
6. The number of special inspections of HUD area and FHA insuring offices that were conducted one year prior to your appointment, that have been conducted since your appointment, and the nature of such inspections.
7. The number of investigations conducted in response to specific complaints during 1971, those conducted since your appointment, the origins

of such complaints during your tenure, disposition of those investigated, and the current backlog of complaints to be investigated.

8. The number of annual income and expense statements received from multifamily FHA-insured project mortgagors during fiscal year 1972, the the number that were subjected to an audit review, the number which were followed up by a letter to the mortgagor pointing out certain reporting or operational deficiencies and the number followed up by a visit to the property by a HUD–FHA representative for verification of reported information.

9. Comparable information (except for visits) to that described in (8) above with respect to annual statements received from nonsupervised FHA-approved mortgagees.

10. Comparable information also with respect to multifamily project cost certification statements.

11. The numbers of builders, real estate firms, and lenders that have been disqualified from doing business under HUD programs during each year 1968 through 1971, and in 1972 for that part of the year for which information is available.

Finally, we would welcome any statement you would care to make as to progress in eliminating conditions that you found which were conducive to laxity in protecting the Federal interest and a lack of detection of fraud and misrepresentation.

Thank you for your cooperation.

Sincerely,

William Proxmire, *Chairman,*
Subcommittee on Priorities
and Economy in Government.

Department of Housing and Urban Development,
Office of Inspector General,
Washington, D.C., November 29, 1972.

Hon. William Proxmire,
Chairman, Subcommittee on Priorities and Economy in Government, U.S. Senate, Washington, D.C.

Dear Mr. Chairman: It was a pleasure to discuss the activities of this office with Messrs. Jasinowski and Schechter of your staff on November 14. I am enclosing information on the eleven specific items set out in your subsequent letter of the 16th.

Secretary Romney's action in creating the Office of Inspector General was but one of the steps taken to correct the weaknesses and abuses found to exist in some of the Department's programs. As will be seen in the enclosures extensive efforts are being made to eliminate inefficiency and to detect fraud and misrepresentation. In addition, emphasis has been placed on the primary responsibility that Assistant Secretaries, Regional Administrators, and Area and Insuring Office Managers have to effectively administer the programs and activities directly under them. Policy and procedural changes have been and are being made in the Department's programs to improve their effectiveness. The role of the Inspector General is that of an independent critical examiner of whether the law, departmental policies, and regulations are being carried out effectively and efficiently. He has no authority to execute programs or direct operations (nor should he), but he does act as an extension of the eyes and ears of the Secretary and other senior departmental management and does make recommendations for elimination of deficiencies and for improvement in program effectiveness.

An elementary requirement for the honest execution of any program is the recruitment and training of qualified and dedicated people who have high personal integrity and who expect it of those with whom they associate. As a part of the effort to assure high standards, in April the Secretary sent a plainly worded letter to all employees (copy enclosed) which cannot be misinterpreted. Also, in February 1972 our office instituted a series of seminars throughout the country in which groups of employees are called together to discuss Standards of Conduct, using actual cases to illustrate the effect of violation of the standards, both on the employee and on the Department. To date, we have met with over 9,000 employees to discuss the standards expected of them.

I am personally convinced that the Department is achieving substantial success in combating the fraud that has existed to some extent in the housing programs. My personal assessment, however, is that we face another nine to twelve months during which additional indictments will be returned on violations of law and regulations which have occurred in the past and which are now coming to light as a result of intensive efforts to ferret out wrongdoing. An example of this effort is the joint Justice Department, Federal Bureau of Investigation, Internal Revenue Service and HUD Office of Inspector General investigations in 13 target cities.

In fairness to the employees of the Department, it must be pointed out that the vast majority are hard-working, dedicated employees. Only a fraction of one percent of our 16,000 employees have been accused of wrongdoing. We should not let the few "rotten apples" who have succumbed to the temptation of a dishonest dollar bring into disrepute the 99 percent plus who are honest.

Sincerely,

CHARLES G. HAYNES, *Inspector General.*

Enclosures.

RESPONSE TO SPECIFIC ITEMS SET FORTH IN SENATOR PROXMIRE'S LETTER OF NOVEMBER 16, 1972 TO THE INSPECTOR GENERAL, DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

1. *Date of Appointment of Inspector General.*

Charles G. Haynes was appointed to the newly created post of Inspector General effective January 30, 1972. Biographical data is attached. The audit, investigation and security functions previously under the Assistant Secretary for Administration were transferred to the Office of Inspector General. The Inspector General reports directly to the Secretary.

2. *The number of people in the Office of Inspector General at the time of appointment, and at present, who are assigned to (a) Investigations and (b) Audit.*

	Jan. 30, 1972, on board	Nov. 30, 1972 On board	Nov. 30, 1972 Ceiling
Investigations:			
Washington	7	6	8
Field	48	59	69
Total investigations	55	65	77
Audit:			
Washington	21	14	16
Field	335	252	291
Total audit	356	266	307
Security	6	6	6
Washington operations and special projects	27	17	18
Administration, policy and plans, analysis and evaluation	29	25	25
Immediate office	0	2	2
Total	473	381	435

For comparability, the January 30, 1972 figures are broken down on the same structure that now exists, as described in the attached Handbook setting forth the organization and functions of the Office of Inspector General. Prior to January 30, 1972, all personnel were assigned to either Audit or Investigations, with Investigations handling the security function and centralized mail and communications for Audit.

Two basic staffing decisions have been made since creation of the Office of Inspector General. As a part of a Department-wide reexamination of manpower needs and a decision to reduce HUD Central Office staffing by 800 positions, a decision was made to reduce project audit work previously done by direct-hire HUD auditors and in lieu thereof accept audits done by independent public accountants. Total audit effort will be increased by requiring local housing authorities, and certain other local authorities to hire independent public accountants, approved by the HUD Office of Inspector General, who will submit biennial audits conforming to guidelines issued by HUD. As a result of this decision and

a decision to reduce audit "overhead" in the Central Office, there was a reduction of 86 audit personnel. Concurrent with this decision there was an authorized increase of 15 investigative personnel to handle increased workload. Secondly, in October 1972, the Office of Inspector General was authorized an increase of 30 positions (12 investigations and 18 audit), all in the field, to intensify efforts to ferret out inefficiency and improprieties. The total authorized staffing for the Office is now 435 of which 360 are in the field and 75 in Washington. The 54 vacancies are being filled as rapidly as possible, consistent with hiring quality personnel. As of November 24, 1972, 32 highly qualified professionals, 26 Auditors and 6 Investigators have been selected and are in various stages of recruit processing prior to joining this office.

3. *Number of HUD employees (a) reprimanded, (b) fired, or (c) indicted during 1968, 1969, 1970, 1971, and 1972 for improper activities in connection with the conduct of housing program business.*

	Calendar year 1968–71	1972 to Nov. 24
Written reprimands		22
Demotions		4
Suspensions		28
Dismissals	6	7
Indicted	7	24

Adverse action activity was very light prior to calendar year 1972 and precise records were not maintained. It is estimated that six employees were fired during the period 1968–71. Employees indicted numbered three in 1968, one in 1970 and three in 1971.

4. *Describe the system of inspections of field office operations, if any, that you have instituted or modified since your appointment.*

The Office of Audit in the Office of Inspector General plans and administers a Department-wide comprehensive audit program to ascertain how well the programs and administrative activities of the Department are carried out. It also makes audits of the activities of grantees, borrowers, contractors, and other recipients of Departmental financial assistance. The Office of Investigation, OIG, conducts investigations and special probes. These are not overall audits or investigations of an office but rather are inquiries into selected activities within the offices.

The principal modification to the audit and investigative activities is a series of special task force inspections of HUD activities in a number of field offices using teams of aduitors and investigators. This is commented on more fully under Item 6. Another significant modification is the increased manpower devoted to internal (management) audits by Office of Audit personnel. The percentage of manpower devoted to internal audits in contrast to project audits has increased from 24% to 38%.

It should be noted that the audit activities of the Office of Inspector General are one of a number of management tools designed to ascertain how well program and administrative activities are carried out. Both the Assistant Secretaries and the Regional Administrators have certain resources to ascertain how well their respective program responsibilities are being performed. Such reports by program officials, including Regional Administrators' advisory team reports, Central Office readiness review team reports, and other program management review reports are reviewed by OIG personnel before proceeding on audit efforts. This is done to avoid unnecessary duplication of effort as well as to devote the bulk of our attention to soft spots disclosed in such reports and by our own preliminary surveys.

Audit efforts usually begin with a survey and pilot audit; if soft spots or significantly deficient areas are indicated, the Office of Audit proceeds with reviews in several Regions at one or more Area Offices in each Region so as to ascertain representatively the extent of deficiencies noted. In this regard, the Department has recently instituted new procedures to provide for program officials to give more prompt and continuing attention to audit findings included in published reports.

5. *The number of routine inspections of HUD area and FHA insuring offices that were conducted one year prior to your appointment, that have been conducted since your appointment, and the nature of such inspections.*

As stated in the comments immediately preceding routine reviews of the overall operations of the field offices are not conducted by the Office of Inspector General. Rather, audits and inspections are made of selected program and project activities in Area and Insuring Offices, quite often as a part of a nationwide audit of a particular program.

The number of visits to each of the Area or Insuring Offices depends on the volume of activity in the area selected for review. In calendar year 1971 (prior to my appointment) our audit reports or survey memorandums covered 86 field visits to 56 of the 77 Area and Insuring Offices. In calendar year 1972, through October 31, 1972, we reported on 98 visits to 56 Area and Insuring Offices.

Examples of the nature of our audits are our review of Section 235 Single Family Housing, reported on under date of December 10, 1971, which included reviews at 52 Area and Insuring Offices most active under the program. Also, our review of Section 236 Multifamily Housing Program, reported on under date of January 29, 1972, included reviews at 21 Area and Insuring Offices most active under the program.

As part of our audits of selected activities we avail ourselves of any evaluation reviews made by management personnel as part of their monitoring responsibilities, and ascertain the actions taken as a result of such evaluation reviews.

As referred to in the preceding item, we also perform on-site or project audits of program participants. In calendar year 1971 we issued 2,004 project (external) audit reports and in calendar year 1972, through October 31, 1972, we issued 1,726 such reports.

6. *The number of special inspections of HUD area and FHA insuring offices that were conducted one year prior to your appointment that have been conducted since your appointment, and the nature of such inspections.*

The term "special inspections" of HUD area and FHA insuring offices is somewhat difficult to define. As previously noted the Office of Inspector General conducts audits, investigations and examinations of HUD programs. It does not make complete over-all inspections of given area or insuring offices. Regional management personnel do make management reviews of the Area and Insuring Offices under their direction.

Examples of what might be considered "special inspections" were investigations conducted during 1971 in 11 cities of operations under Section 235 and related sections of the National Housing Act. These investigations included the review of certain aspects of the operations of the appropriate Area and Insuring Offices. They resulted in the referral of 86 prima facie violations of criminal law to the Federal Bureau of Investigation.

Another example of "special inspections" is the intensive cooperative target city effort being undertaken jointly with the Department of Justice, U.S. Attorneys, Federal Bureau of Investigation and Internal Revenue Service. During 1971 there were five "target cities" and these have been expanded to 13 during 1972. Intensive joint effort is being made to discover fraud and to indict and convict those responsible.

Another area of "special inspections" is the Office of Inspector General probes into HUD operations in cities other than the target cities. Special probes are now being made in New Orleans, Jacksonville and Seattle by Office of Inspector General teams composed of investigators, auditors and technical personnel from other elements of the Department, as required. These probes will be continued until all 77 offices are examined by either the target city cooperative effort or by the special OIG teams unless, of course, experience shows they are unproductive. These special probes are in addition to the normal audit and investigative effort.

Another special effort was a review of property disposition activities in Detroit, by an OIG team composed of an investigator and three auditors. It resulted in the referral of 32 prima facie violations to the Target Cities Task Force and the suspension of three HUD employees and 30 contractors doing business with HUD.

There has been a significant increase in what might be considered special inspections since the creation of the Office of Inspector General in January 1972 but the increase is not measurable in meaningful quantitative terms.

7. *The number of investigations conducted in response to specific complaints during 1971, those conducted since your appointment, the origins of such complaints during your tenure, disposition of those investigated, and the current backlog of complaints to be investigated.*

The number of investigations initiated by the Office of Inspector General and/or the Federal investigative agencies during 1971 in response to specific complaints

was 1,865. During the period January 1 to October 31, 1972, a total of 2,254 investigations have been initiated. Complaints were received from all types of participants in HUD programs, particularly FHA-assisted homeowners, as well as HUD employees, the news media, Congress and the general public. In addition, some cases are opened as a result of facts uncovered in OIG audits. Statistics are not maintained on the number of complaints received from each source. The disposition of the cases investigated in 1971 and 1972 resulted in 601 significant administrative actions; over $2,369,000.00 in monetary recoveries; and Federal prosecutions which resulted in 48 individual imprisonments totalling over 70 years, 84 individual probations totalling over 180 years, and fines over $70,000. As of October 31, 1972, the total backlog of cases to be investigated and under investigation by ourselves and other investigative agencies amounted to 1,930 cases.

8. *The number of annual income and expense statements received from multifamily FHA-insured project mortgagors during fiscal year 1972, the number that were subjected to an audit review, the number which were followed up by a letter to the mortgagor pointing out certain reporting or operational deficiencies, and the number followed up by a visit to the property by a HUD–FHA representative for verification of reported information.*

During fiscal year 1972, HUD received annual income and expense statements from about 6,700 multifamily project mortgagors. Pursuant to HUD requirements, each project mortgagor is required to have his financial statements examined and certified to annually by an independent certified public accountant or independent public accountant. Audits of selected areas of mortgagor operations are also made by the Office of Inspector General pursuant to requests by program officials; during fiscal year 1972 we made 114 complete audits and 116 limited reviews of project mortgagors.

HUD program officials reviewed 4,816 of the statements received, sent letters to 1,153 mortgagors requesting clarifications, and made 206 visits to mortgagors.

9. *The number of annual income and expense statements received from non-supervised FHA-approved mortgagees during fiscal year 1972, the number that were subjected to an audit review and the number which were followed up by a letter to the mortgagee pointing out certain reporting or operational deficiencies.*

During fiscal year 1972, HUD received annual balance sheets and income and expense statements from almost 1,600 nonsupervised FHA-approved mortgagees. Under HUD regulations, an annual audit of each mortgagee's balance sheet and income and expense statements is required to be made by an independent certified public accountant or an independent public account. Pursuant to requests from HUD officials, the Office of Inspector General has done additional audit work during fiscal year 1972 on 247 mortgagees (19 complete audits and 228 limited reviews). During fiscal year 1972, 1,468 statements were analyzed by the Mortgagee Approval Section, HPMC, of which 491 required written follow-up for additional information or error corrections.

10. *The number of multifamily project cost certification statements received during fiscal year 1972, the number that were subjected to an audit review, the number that were followed up by a letter to the mortgagor pointing out certain reporting deficiencies, and the number followed up by a visit to the property by a HUD-FHA representative for verification of reported information.*

In fiscal year 1972, HUD received multifamily project cost certification statements on each of about 1,700 cases finally endorsed. In accordance with HUD regulations, the cost certification statements are required to be examined and certified by an independent certified public accountant or an independent public accountant. In addition, the Office of Inspector General made 61 cost audits to test the adequacy of such CPA certified statements and to respond to program officials' requests for audits.

Each case is subjected to review steps as shown in the case folder although no summary record on follow-up is maintained. Requests for additional information may be handled by phone; by visits from the sponsor, contractor, mortgagor, or legal representative; or by return of the statements for clarification of specific items. Costs are either accepted or disallowed based on reviews in HUD, including comparisons with estimated costs by line item. Significant disallowances are discussed at a preclosing conference. Approval of a certified cost statement is indicated by proceeding to final endorsement.

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11. *The numbers of builders, real estate firms, and lenders that have been disqualified from doing business under HUD programs during each year 1968 through 1971, and in 1972 for that part of the year for which information is available.*

Lenders disqualified

Calendar years:	
1968	4
1969	15
1970	14
1971	7
1972 (to November 28, 1972)	20

BUILDERS AND REAL ESTATE FIRMS (COMBINED) DISQUALIFIED OR RESTRICTED

	Title I of National Housing Act[1]	Sec. 512 of National Housing Act	Unsatisfactory risk determination	Departmental suspensions
1968	(2)	82	149	(3)
1969	273	81	126	(3)
1970	279	53	126	(3)
1971	112	68	71	(3)
1972 (through October)	66	56	132	142

[1] Action taken under title I of the National Housing Act consists of placing an individual or dealer on the FHA precautionary measures list. This does not disqualify the individual or dealer from doing business with HUD, but establishes more stringent regulations under which the lender must closely supervise the activities of the listed individual or dealer.
[2] Not available.
[3] Suspension program had not been implemented.

THE SECRETARY OF HOUSING AND URBAN DEVELOPMENT,
Washington, D.C., April 21, 1972.

To: All HUD employees.
Subject: Employee conduct.

It is time for plain language. I am sick and tired of the cases being brought to my attention by the press, the Congress, the Justice Department and our Office of Inspector General, which show that some of our employees are accepting favors in the form of meals, gifts, entertainment, preferential treatment in business dealings and other gratuities from those who participate in our programs. There is no excuse for this kind of petty chiseling and in some cases outright bribery.

I will not countenance violations of our standards of conduct, and have directed that firm, but fair, disciplinary action be taken in every proven case, including action against those supervisors who have knowledge of such activity and condone it through inaction. In one recent case a builder who provided meals, entertainment and Christmas gifts to employees of an Area Office told our investigators that it would be naive to believe that his company didn't expect to receive future benefits from the HUD employees who accepted the gifts. Learn to say "No." You'll find that with a little practice it comes easy.

I do not criticize the great majority of HUD employees who are effective and dedicated to public service and who do not accept such gratuities, but there are too many who do. I am asking that this memorandum be given to each HUD employee and printed in housing industry periodicals so that there will be no doubt as to where we stand on this issue.

GEORGE ROMNEY.

Chairman PROXMIRE. On Thursday the subcommittee will reconvene to hear Mr. Arthur Burns, the Chairman of the Federal Reserve Board, and Stanley Waranch, president of the National Association of Homebuilders.

Thank you very much.

Mayor GRIBBS. Thank you, sir.

(Whereupon, at 12:25 p.m., the subcommittee was recessed, to reconvene at 10 a.m., Thursday, December 7, 1972.)

HOUSING SUBSIDIES AND HOUSING POLICIES

THURSDAY, DECEMBER 7, 1972

CONGRESS OF THE UNITED STATES,
SUBCOMMITTEE ON PRIORITIES AND
ECONOMY IN GOVERNMENT OF THE
JOINT ECONOMIC COMMITTEE,
Washington, D.C.

The subcommittee met, pursuant to recess, at 10 a.m., in room G-308, Dirksen Senate Office Building, Hon. William Proxmire (chairman of the subcommittee) presiding.

Present: Senator Proxmire and Representative Conable.

Also present: Loughlin F. McHugh, senior economist; John R. Karlik and Courtenay M. Slater, economists; Lucy A. Falcone and Jerry J. Jasinowski, research economists; George D. Krumbhaar, Jr., and Walter B. Laessig, minority counsels; and Leslie J. Bander, minority economist.

OPENING STATEMENT OF CHAIRMAN PROXMIRE

Chairman PROXMIRE. The subcommittee will come to order.

In the first two days of the subcommittee's hearings, the focus has been on evaluating the effectiveness of Federal housing programs and subsidies. The thrust of the evidence we have gathered is that HUD has grossly mismanaged these programs and significantly inflated Government costs in this area. For those who doubt this assertion, I recommend a look at the record of examples of the 100-percent cost overruns for the legal and organizational fees associated with 236 rental subsidies, the HUD land appraisals that are inflated by 25 percent, and the dismal promise of HUD housing defaults that could cost the taxpayers one-half billion dollars.

Today we turn to the major cost problem in housing—the feast-or-famine nature of housing construction and mortgage credit. In the first place the overall costs of housing is, of course, directly related to the total supply produced. Unfortunately, the Federal Reserve's frequent shifts to a tight money policy reduce the availability of mortgage money, raise mortgage interest rates, and reduce the overall supply of housing. Such an inadequate housing supply tends to breed inflationary rises in housing rents and prices.

Furthermore, high interest rates greatly increase the homeowner's cost of purchasing a home. As it now stands the financing of a house costs as much as the entire house—that is, as much as the land, the construction, the labor, and so on. At present interest rates, which have on average been a couple of percentage points higher in the last 4 years than throughout the sixties, about one-half of the American families

cannot afford to buy a home, and the extra cost to those who can afford to buy is tremendous. Two percentage points in the mortgage interest rates increase the typical family's mortgage interest payment by $28 a month, $336 a year, or $8,400 over the life of a 25-year loan.

In addition, the great instability in the availability of mortgage money and interest rates is not conducive to efficiency and cost reduction in homebuilding. A private builder's costs skyrocket if he builds 750 units one year and only 150 the next. He finds it impossible to organize his work force efficiently. As one witness pointed out, he cannot hold competent help. People just do not like that kind of employment and they leave the industry. He has to train new people, who are not as competent as they should be. He finds it difficult to make savings by buying in quantity, to use his capital equipment effectively to train his employees, to build a quality product, or to provide equilibrium in his inventory. The housebuilder may even "pad" his cost to protect himself against money market uncertainties.

There is also a direct impact on Federal costs of subsidized housing programs when interest rates rise. High interest rates on long-term mortgages or bonds used to finance housing projects have to be absorbed through increased subsidies under present programs. Contractual annual housing assistance payments are raised significantly, and the cumulative effect over 30 or 40 years for all of the programs is to raise Federal expenditures by billions of dollars.

We are concerned, therefore, with possible methods of alleviating the cyclical mortgage money shortages and high interest rates. The Board of Governors of the Federal Reserve System has given this matter some consideration in a report released in March of this year. The Board has also recommended four priority considerations and Chairman Burns has reaffirmed today a flexible instrument tax credit which might be of help to moderate fluctuations in residential construction. I think the spirit of your report, Chairman Burns, is good because it shows, for the first time as far as the Fed is concerned, some appreciation of the need to moderate mortgage credit fluctuations. Unfortunately, your recognition of the need to do something has not been matched by recommendations that are economically or politically sound. And as politically sophisticated as you are, Mr. Burns, what makes you think that the Congress is about to delegate such powers to this President or any President? I have other substantive criticisms of your recommendations and I will raise them in the course of questioning.

I would make one other remark about your recommendations on what to do about the high cost of mortgage credit. The thrust of those recommendations is to point the finger at what everyone else should do rather than to decide what the Fed should do.

As an alternative to your passing the buck I propose that the Congress authorize the Federal Reserve Board to limit the amount of borowing by large corporations during a period of tight money. Corporations covered would be confined to those with annual sales in excess of $100 million. (Tier I corporations under the price control program). The limitations on borrowing would be expressed as a percentage of the borrowing conducted by each corporation during a specified base period with adjustments for hardship cases. By limiting big business borrowing, more money would be available for other

sectors of the economy including housing, State and local government, small business, and agriculture. By restricting demand, interest rates would not rise as much as they otherwise would.

After we have heard from Mr. Burns the hearings will be concluded by testimony from a spokesman for the housing producers of the country, Mr. Stanley Waranch, president of the National Association of Homebuilders. It is important that we should know how the builders view the present incentives for production, the problem that they see in present programs and proposed alternatives, and their recommendations for improvement.

Mr. Burns, in view of my above remarks, we now look forward to hearing the views of the man who has the most to say about the cost of mortgage credit in this country than anyone else. There is no time limit on your presentation because we have had a chance to look at it and it is a concise statement, and we appreciate your accommodating that to the subcommittee's needs.

Mr. Burns, it is all yours.

STATEMENT OF HON. ARTHUR F. BURNS, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM

Mr. Burns. I am very happy to have the opportunity to make my presentation, although I must say that I wonder a little whether I should do that in view of the fact that you have already seen fit, Senator, to refute my presentation before I made it. Do you really want me to make my statement?

Chairman Proxmire. Of course, I do. I read the statement and I think it is a good statement. If anybody can refute a refuting Senator, it is you, especially in this area. We have great respect and admiration for your competence and I do not think you should be at all abashed by the fact that I started off on a challenging statement.

Mr. Burns. No, I am not abashed at all.

Chairman Proxmire. I am sure you are not.

Mr. Burns. I am so eager to refute your statement, Senator, that I am almost willing to forgo reading mine.

Chairman Proxmire. That would be an acceptable approach.

Mr. Burns. I will read my statement, and we will have our debate in due course.

Let me therefore say, putting all preliminaries to one side, say that I really do appreciate this opportunity to discuss with members of this subcommittee measures for moderating cyclical swings in the availability of credit for housing.

In a report submitted last March, the Federal Reserve Board set forth recommendations to accomplish that objective. Before reviewing those recommendations, it may be useful to comment on recent developments in the markets for housing and mortgage credit, and to assess prospects for the year ahead.

The flow of savings into the thrift institutions that specialize in mortgage lending has shown extraordinary strength for more than 2 years. Commercial banks and other financial institutions have also been abundantly supplied with funds for lending. As generally happens in times of ample credit availability, housing credit and con-

struction have expanded rapidly. In fact, residential mortgage loans have grown at an unprecedented rate. Growth in the first three quarters of this year was at an annual rate of $46 billion, compared with $36 billion in 1971 and less than $20 billion in most other years.

Savings and loan associations and mutual savings banks accounted for about two-thirds of the expansion in residential mortgage loans in 1971 and 1972. Life insurance companies have continued to reduce their investment in mortgages on 1- to 4-family dwellings. On the other hand, commercial banks have been able this year to accommodate business and related loan demands and at the same time expand their portfolios of residential mortgage loans at a record annual rate of $10 billion.

Homebuilding began to respond vigorously to easier credit conditions during the second half of 1970, and thereby provided a much needed stimulus to general economic activity. This year housing starts will probably reach a new peak of more than 2.3 million units, not counting mobile home shipments, which should exceed 550,000 units.

Interest rates on home-mortgage loans are now only a little higher than they were earlier this year, and the rise has been associated in part with more liberal nonrate terms on conventional loans and larger loan amounts. In October rates for conventional loans on new homes averaged about 7.60 percent, up 10 to 15 basis points from their recent low last spring, but still somewhat below their August 1971 level and some 90 basis points below their peak in the summer of 1970.

Further expansion in overall business activity in 1973 might put upward pressure on short-term interest rates. There is, however, no imminent threat of a substantial diversion of savings flows from mortgage-oriented thrift institutions into market securities. In recent years, these institutions have managed to increase appreciably the proportion of their liabilities taking the form of longer-term deposit certificates with attractive yields. Moreover, minimum denominations of Treasury bills and various agency issues have been raised, and this too should help to moderate deposit withdrawals. Deposits should thus continue to grow at a good rate, even if the recent phenomenal pace is not sustained. And supplementary support can be expected from FNMA, the Federal home loan banks, and related sources when and as needed.

Since backlogs of demand have been filled and vacancy rates are now rising in some areas, production of housing in 1973 may be below this year's record level. But with funds for mortgage credit continuing in relative abundance, the pace of residential construction should continue ahead of that required to meet the national housing goal established by the Congress in 1968.

Encouraging as these developments are, we should not lose sight of the need to make the mortgage market less vulnerable to the storms by which it has been buffeted periodically in the past. On a sunny autumn day, the prudent commuter gets out his snow tires. Chances are he will need them some time during the winter, and it is best to get them on before the snow falls. It is comforting to know that this committee is mindful of the need to help others prepare for winter weather.

Past experience indicates that at certain stages of the business cycle, forces develop that diminish the availability of funds for home loans. Mortgage credit for housing is typically in short supply when the demand for credit from other sectors rises rapidly. In a briskly expanding economy, business demands for credit from banks and the public market normally increase to finance additions to plant, equipment, and inventories. Interest rates then tend to rise, and the supply of credit available for other borrowers is squeezed. The shortage of credit may be intensified if the aggregate demand for goods and services threatens to exceed the Nation's productive capacity. For in that event monetary policies designed to restrain demand and to curb inflation will further restrict the available supply of credit to borrowers.

The difficulties experienced by the housing industry stem in significant measure from the fact that homebuyers depend heavily for credit on institutions that are in a poor position to compete for funds when market rates of interest rise sharply. Their deposit inflows then shrink, and so does their ability to sustain the flow of mortgage credit. Legislative and regulatory limits on mortgage interest rates also constrict the flow of funds to housing in periods of general credit restraint.

Other classes of borrowers, particularly business firms, are less affected by general credit restraint. Established business enterprises not only enjoy preferred status as customers of commercial banks; they often also have access to alternative sources of credit in money and capital markets. Thus in periods when the aggregate demand for goods and services becomes exuberant, the share of new loan funds absorbed by business tends to rise, while that for housing falls.

While it may not be possible or even desirable to eliminate cyclical fluctuations in the supply of credit for housing, the feast-to-famine swings that we have experienced in the past have clearly been excessive. In its report to the Congress submitted last March, the Board made several recommendations for smoothing out these cyclical variations in the supply of housing credit and hence in housing construction. I will summarize the reasoning behind these recommendations briefly.

First, the Board believes that the main thrust of new initiatives should strike directly at the sources of fluctuation in housing credit. Accordingly, the Board recommends removal of a number of legislative and regulatory constraints that at times discourage investment in mortgages. Interest-rate ceilings on FHA and VA loans, intended as protection for homebuyers, have meant in practice that this form of financing periodically dries up, or becomes available only if the seller is willing to pay several "points" as a loan fee. Recognizing this fact, the Congress has allowed greater flexibility in these ceilings by authorizing their adjustment by administrative action. Even so, the ceiling rates often lag behind market developments. If Congress abolished the ceilings, or tied them directly to market interest rates, it would encourage the States to take similar action with regard to usury laws, which have also served to block the flow of funds into mortgages.

Other changes in Federal legislation would be helpful. The Federal Reserve Act should be amended to permit the Federal Reserve banks to lend to member banks on the basis of sound mortgage col-

lateral at the regular discount rate. The statutory restrictions on real estate loans by national banks should be eliminated so that mortgage lending by these banks may be governed mainly by considerations of safety and soundness, tested by examinations, as other types of loans are. When that is done, the Comptroller of the Currency should however be authorized to establish safeguards through such regulations as may seem necessary from time to time. Removal of the geographical restrictions on conventional mortgage loans of Federal savings and loan associations would help free funds for investment where the need is greatest. As in the case of FHA and VA rate ceilings, such actions at the Federal level could lead to similar liberalization of State laws.

Steps should also be taken to strengthen the ability of depositary institutions to attract and hold consumer savings when yields are rising on market securities. The thrift institutions that specialize in mortgage lending are particularly vulnerable at such times because of the disparity between their assets, which consist of long-term loans with fixed yields, and their liabilities, which are short-term. When market rates rise, savings tend to be diverted from thrift institutions into market securities because the institutions are unable to raise their rates to meet the competition. And when deposit inflows shrink, the supply of mortgage credit also declines.

The sharp swings in deposit inflows and in loan activity at these institutions could be moderated somewhat by lengthening the average maturity of their deposits. Some progress has been made, and is being made, in this direction but more could be done, perhaps by adjusting deposit rate ceilings to allow greater incentives for savers to invest for longer periods.

Some benefits would also accrue from shortening the average life of the earning assets of thrift institutions, although any sizable move in this direction should come only after careful consideration of the potential impact on the supply of mortgage credit in the long run. Some benefits can probably be gained by encouraging the specialized mortgage lenders to put a modest portion of their earning assets into consumer loans. Then their earnings would respond better to changes in market interest rates, and they would be in a somewhat better position to adjust the rates they pay on deposits so as to maintain savings inflows.

Another step well worth considering would be to enable all depositary institutions to offer mortgages with variable interest rates and attendant safeguards, side by side with the traditional fixed-rate mortgage. Since the variable-rate mortgage would result in more flexible average earnings rates, the institutions could compete more effectively for deposits. Steadier deposit inflows, in turn, would mean greater stability in the availability of mortgage credit during business cycles. Moreover, this greater stability could be achieved without affecting adversely the long-run supply of mortgage funds.

Along with these benefits would come some costs. The risk of interest rate fluctuations would be a complicating factor in the planning of homebuyers who chose a variable-rate mortage. But this difficulty could be kept within reasonable bounds by putting limits on the amount that the rate could vary, and by providing that the monthly payment

would normally remain fixed, with rate changes affecting only the term to maturity. To protect borrowers and facilitate rational choice, the lenders should be required to make full disclosure about variable-rate and fixed-rate mortgages. And needless to say, the contract should provide for adjustments both ways—to reflect reductions as well as increases in interest rates.

It would probably take 10 years or more for variable-rate mortgages to become a substantial element in the portfolios of depositary institutions. But they have the potential, in time, of playing a key role in smoothing out flows of funds into home loans, and their encouragement therefore deserves serious consideration.

For the immediate future, the best hope for greater stability in housing lies in continued progress in controlling inflation, and particularly in better management of our fiscal affairs so that less reliance would need to be placed on credit policy to stabilize the overall economy. By making greater use of fiscal tools, sectors of the economy that are relatively immune to monetary policies could be made to bear their share of restraint during periods of excess demand.

Specifically, the Board recommends flexible use of the investment tax credit as a means of achieving greater stability in outlays by business firms for machinery and equipment. These expenditures are large, cyclically volatile, and relatively insensitive to monetary policy. During periods of credit restraint, expenditures for machinery and equipment have repeatedly drawn on resources that otherwise would have been available for housing.

If the investment tax credit were lowered in boom times and raised in slack periods, we would experience more stability in business demand for external financing, and therefore also in market interest rates and in the flow of funds for housing. This tax flexibility could be achieved by authorizing the President to vary the investment tax credit within prescribed limits, perhaps from zero to 10 or 15 percent. Before a change in rate could become effective, a 60-day waiting period should be allowed for disapproval by either House of Congress, analogous to the procedure for reorganization plans.

Among the recommendations in its report, the Board believes that first priority should be given to the proposed variable investment tax credit. Establishment of machinery for flexible use of the investment tax credit would yield benefits more quickly than can be expected from the other recommendations, and the benefits would be substantial, not only for housing but also for other sectors that are sensitive to fluctuations in credit conditions.

In closing, let me commend this committee for drawing attention to the need to improve credit arrangements for housing. We should take advantage of the breathing spell we are now enjoying in order to prepare for problems that may develop in the future.

Thank you.

Chairman Proxmire. Thank you, Mr. Burns. I hope that you will not view my questions, however they may disagree with you, as being hostile at all, or being in any way a reflection of lack of respect, because I have great respect for you, as you know.

You ended up by saying we should take advantage of the breathing spell we are now enjoying in order to prepare for problems that may

develop in the future. Well, that is what I want to address myself to in this first question.

I studied your statement and with all respect, I just do not see any significant assurance on this sunny autumn day as you put it, that we prudent commuters are really getting ready to put on our snow tires, as far as financing housing in the credit crunch is concerned. Now, what do you suggest? First, you say knock out the ceiling in FHA and VA interest rates. I think this makes a certain amount of economic sense and I might very well support it. The result might be to make more mortgage money available, but at higher prices or interest rates and at a rate that would tend to exclude millions of potential home buyers from the market. It isn't a real answer to our problem of the credit crunch devastating housing.

Second, you suggest using the Federal discount window, discount mortgage. I like that very much. But, the discount window, as you know, has in recent years been one of the most neglected of the credit instruments that we have. It was very useful in the liquidity crisis, most recent liquidity crisis, but by and large it has been a neglected instrument. I would not hold my breath until it is used by banks in a substantial way for discounting mortgages, although it could possibly be helpful. But, at any rate, this does not seem to me to be a substantial suggestion either.

Third, you suggest lengthening the maturities and providing for flexible incentives, higher interest rates for S. & L. depositors who deposit for a longer time. Again, I think that is good but this is likely to take time, just as you say, to break S. & L. depositors of their habit. It seems to me it is a long-range approach.

You also propose variable interest rates. This is imaginative but you, yourself, say it will probably take 10 years or more before this instrument provides a substantial element in the portfolios of these banks.

That leaves the investment credit, which I say would have the most immediate effect and, as I said in my opening statement, I just do not see how this Congress, with all of the difficulties we have had in our differences with the President of the United States, delegating to this President or any President this kind of authority over one of the clear Constitutional responsibilities that resides in the Congress. So, that does not leave me with very much except your statement that what would help housing the most is the reduction of inflation. Maybe through better fiscal policy. But, that does not make it clear to me what the Federal Reserve Board is going to do to help housing.

Mr. Burns. Let me turn first to the Federal Reserve Board and its role with regard to housing credit and next I shall comment on the investment tax credit.

You know, Senator, your comments remind me of some lines in Gilbert and Sullivan that go something like this: "If you wish in the world to advance, your merits you are bound to enhance. You must stir it and stump it, and blow your own trumpet. Or, trust me, you haven't a chance."

Now, I have not blown the Federal Reserve Board's trumpet.

Chairman Proxmire. I would sure like to hear it blow.

Mr. Burns. You will, if you force me to.

First, in my statement I did not refer at all to the action that the Federal Reserve Board took in September 1971, when we undertook to make investments in agency issues, including housing issues. Up to that time, to the extent that we dealt in housing agency issues, we confined our activity to repurchase agreements.

Since September 1971, our investment in agency issues has grown and now amounts to a billion and a quarter dollars. When we started, the differential between Treasury issues and agency issues was some 40 to 50 basis points. Now, I believe that it has narrowed to some 10 or 15 basis points. In part, this narrowing of the differential is due to the growing market generally for agency issues. But, in part, the action of the Federal Reserve is responsible for the narrowing. I have not mentioned this in the Board's report on housing because it was something we had already done.

Second, in our report I do refer to the possibility of adjusting key rate ceilings, those under regulation Q, so that interest rates on long-term deposits could be raised by the thrift institutions. This is something that we have under consideration. In the report I say merely that some more progress could be made, perhaps by adjusting these rate ceilings.

Third, Senator, let me turn to one sentence in my statement and elaborate on it. It is a quiet sentence which reads as follows: "For the immediate future, the best hope for greater stability in housing lies in continued progress in controlling inflation and, particularly, in better management of our fiscal affairs so that less reliance would need to be placed on credit policy to stabilize the overall economy."

Now let me interpret that sentence. What I am saying, in effect, is that if we make progress in controlling inflation, then interest rates will be lower because the inflation premium now built into interest rates will come down. Beyond that, and bearing more particularly on the Federal Reserve Board, what I am saying is that we at the Board have, in recent years, tried to pursue a policy of continuous moderate growth in the monetary aggregates. We have sought to avert spurts of rapid credit expansion, on the one hand, and to prevent credit crunches, on the other.

I think, Senator, that a policy of moderation such as that by the Federal Reserve will do far more to stabilize credit for the housing industry, and consequently to stabilize production in that industry, than any single proposal, or any set of proposals, ever made by anyone. That is a considered judgment. The Federal Reserve Board is pursuing and hopes to continue to pursue that policy.

Chairman Proxmire. May I just interrupt?

Mr. Burns. May I just finish briefly?

Chairman Proxmire. Yes.

Mr. Burns. In my judgment, the fact that this consideration is not trumpeted in the report is no reason for neglecting its great significance for this country's future.

Chairman Proxmire. Well, I would agree wholeheartedly, and now I am not going to disagree that it would be very helpful, if we could get inflation under control and reduce the present rate of inflation sharply. And very happily, very much of what the Federal Reserve Board has done in recent years, certainly has my wholehearted approval, especially with respect to monetary aggregates.

But, the fact is that if we rely on fiscal policy, what does that mean? That means increasing taxes, which is very hard to do and, at the same time, reducing expenditures, the area where expenditure is most likely to be reduced, one of the big areas is in housing. Housing has been particularly vulnerable in all of our administrations when budget cuts are made because housing depends so much on providing capital, which is such a big element, and has been such a big element in the budget. At any rate, fiscal policy is no very easy solution to this problem. A tough hold-down-expenses fiscal policy might have an adverse effect, at least for a time, on housing itself.

You see, one of the things that bothers me, and makes my statement more contentious than you would like, is the fact that at the present time mortgage rates are still at 7.6 percent. That is far, far higher than they were throughout the decade of the sixties when they averaged 6.2 percent. Now, that difference is a very significant difference in pricing many, many people out of the housing market who should be able to buy homes and who have worked hard to earn incomes of \$9,000, \$10,000, \$11,000 a year and cannot afford with that income to buy homes. Now, this is what concerns me very much and I do not see anything in the program that we have had before us today which is going to improve that situation significantly.

Furthermore, I do not see anything that is going to alleviate the kind of crunch which might very well develop in the future. I do wish you would address yourself to the concrete proposal I made; that the Federal Reserve Board be given the authority to limit borrowing by corporations with sales over \$100 million, the tier I corporations, as one alternative way to assure that a credit crunch does not impose a disproportionate burden on small business and housing and State and local capital needs.

Mr. Burns. Well, I will address myself to your question. But I also do not want to neglect your earlier questions. They too are important, and I want to comment on them.

First of all, let me make doubly clear that it is the wish of the Federal Reserve Board to pursue a moderate course in its monetary policy. To the extent that we are able to realize it, we will be doing the most important single thing that can be done, and it is far more important in my judgment than any other measure or combination of measures, for the stability of housing credit and the production of housing.

Next, what about fiscal policy? You commented on the difficulties in carrying out a flexible policy. There are difficulties, of course, and I will be glad to discuss that whole range of questions with you. But, let me comment first on one or two of your criticisms of the one specific proposal concerning fiscal policy that the Board has made to the Congress; that is, the proposal with regard to the investment tax credit. You pointed out that the Congress would be reluctant to adopt such a proposal and I think you described it as a naive proposal. I do not think it is naive at all.

It would be presumptuous on my part to take issue with you on what the Congress is or is not likely to do. I do not intend to do that. But I do want to point out that the Board's proposal for a variable investment tax credit does not give exclusive authority for that kind of a change to the President of the United States. On the contrary, in

the Board's proposal, the Congress becomes a full partner in regulating the variable investment tax credit.

You may have overlooked this, Senator, but it is very important. Economists over the years have made proposals to the Congress that the President be given authority to vary the income tax for individuals. The proposal of the Board differs from that type of proposal precisely because we recognize that the Congress will not, and should not, give up its power over the purse. In our scheme, the President merely makes a recommendation to the Congress and then the Congress can veto the proposal. That would be done under machinery similar to that now used by the Congress in handling matters under the Reorganization Act.

The reason for this procedure should be perfectly obvious; namely, we would want the Congress to focus on that one tax proposal. Reorganization machinery makes it possible for the Congress to do just that without the distraction of complicating amendments.

Reorganization Act machinery also insures action within a limited period. You may quarrel with the suggestion that the Congress be given merely 60 days. You might want a longer period, and that is something that the Board would not take a firm position on. In other words, we want the Congress to play its part and to play its part fully in varying the investment tax credit. This power would not be delegated to the President.

If I may, I shall turn now to your suggestion about limiting the borrowing that is to be done by big corporations. Senator, as far as I am concerned, big corporations, small corporations, big partnerships, small partnerships, big individual proprietorships or small, all have a role in this economy. I do not think that the Federal Reserve Board should be given a club over small business or a club over big business. If the Congress wants to apply a club over big business at any time, I think that is a prerogative that Congerss should exercise itself. I do not think that the Congress should ask the Federal Reserve Board to make decisions on basic political questions of that character. Our task is to regulate the overall supply of money and credit. I do not think it is our task or should be our task to determine national priorities with regard to the use of credit. This is a high privilege of the Congress and of the President. I do not think that you, Senator, in seeking to protect the privileges of the Congress, and rightly so, should now be asking the Federal Reserve Board to undertake that which has historically been the privilege of the Congress.

Chairman PROXMIRE. Mr. Burns, my time is up. Let me just say before I yield to Congressman Conable, that we all know, and you are very sensitive to this, the Federal Reserve Board credit policy has had a particularly disproportionate effect on housing. It is not—you do not do this because you think housing has a lower priority. Fed policies have simply had that effect. Monetary policy happens to have a profound effect, far more profound on housing because borrowing is so important in home building and because the borrowing term is over such a long period. As you know, the Maisell Study showed the effect of the 1966 credit restraint was devastating to housing, almost to the exclusion of other elements or most other elements in

our economy, so you do affect priorities, unconsciously, perhaps, and without any malice certainly. But, nevertheless, you do affect priorities.

What I am suggesting is that we all know that big business is effectively insulated from monetary policy because they have so many ways in which they can borrow and they are in such a position to pass on the cost of borrowing to their customers. In the first place, they pass on half the cost to the Federal Government because of the corporate income tax. In the second place, in many instances, they have the market power to pass it on to their consumers. At any rate, they are in a far better position, and this has been repeatedly demonstrated than housing is. This is why I thought this additional instrument of Federal Reserve Board restraint of big business borrowing might be very wise and desirable. You would be in a far better position to restrain that segment of the economy which we all agree should be restrained. I think some people even in the big corporations might agree that this would be a wiser policy than virtually pushing housing into a depression. That is what I have in mind.

Congressman Conable.

Representative CONABLE. Well, would you like to comment on that, Mr. Burns?

Mr. BURNS. Well, thank you, Mr. Conable.

Representative CONABLE. Let me ask you this: Is it possible to restrain credit for large corporations?

Mr. BURNS. Well, that is precisely what I was going to comment on next. Yes; I think the Federal Reserve Board could restrain the flow of credit to large borrowers from member banks of the Federal Reserve System. That is all that it could do. Non-member banks——

Representative CONABLE. Would they not get credit from other sources?

Mr. BURNS. That is just my point. Nonmember banks would be excluded, life insurance companies would be excluded, pension funds would be excluded, other financial institutions would be excluded.

Now, I think, Senator, before you ask the Federal Reserve Board to undertake this responsibility, you ought to give the Federal Reserve Board the power to carry it out.

Chairman PROXMIRE. Well, if I could and I apologize again, but, of course, what I had in mind was not that we do this, under existing law. What I would provide is that the law would apply directly to the corporation. We now have a much more far-reaching law, as you know, with price and wage controls as you have pointed out many times. But, what I would provide is that the corporation simply would be restrained in their borrowing to the amount they used in a base period unless they had a hardship case. In that case they could come to the Federal Reserve Board for relief. I would apply this to all borrowing by corporations. Otherwise you, of course, are absolutely right. It would not have any effect.

Representative CONABLE. What about equity financing?

Chairman PROXMIRE. All borrowing. Equity financing is not borrowing. I think that the equity financing would not distort the credit market, and I would certainly exclude that.

Mr. BURNS. Well, equity financing draws on funds available for investment, just as credit financing does.

Chairman PROXMIRE. This is a matter of judgment. In my view, equity markets are different, quite different from credit markets. Maybe they are not that different. There are forms of equity financing, preferred stock, for example, that is similar but by and large I think there is a substantial difference and they are not competitive.

I thank you, Congressman Conable.

Representative CONABLE. I am sorry I was not here at the outset, Mr. Burns. It is a long way over here from the House side and certainly the Chairman's introduction brought forth a clarion note of the trumpet. I agree generally that the posture of the Federal Reserve Board, as a comparatively low silhouette institution, is a desirable posture; that too much blowing of the trumpet is likely to bring the walls of political independence down. Since you perform to a substantial degree a corrective function when fiscal policy is defective, it probably is a good idea not to have too much trumpet blowing back and forth, or we could develop a posture of antagonism that would not be good for the independence of our economy. So, I would like to say that I think, generally speaking, the posture you assume is an appropriate one and probably in the long term is in the best interest of the country.

I would like to look at the investment tax credit a little more. Like the chairman, I am somewhat concerned about delegations of congressional authority. This is a very sensitive area nowadays and likely to be more sensitive as this year wears on, I suspect. However, what we have had with the investment tax credit has probably been the worst of possible worlds. We have been on again, off again, in a way that has been quite disruptive to planning, that has not achieved any effective fine tuning and that has generally, I think, discredited what should be a valuable fiscal device. I can see some advantage, therefore, in leaving within certain limits some expert flexibility in the use of this. Is there not a good deal of disruption though, from changes in the investment tax credit over the short-term period? I am going to be very reluctant to do anything within the investment tax credit right now because it seems to me we have created so much chaos by going on again, off again so frequently and I guess that is the major reason for my reluctance about delegating this authority, even within a fairly well defined limit.

Mr. BURNS. Congressman Conable, you have commented on the history of the investment tax credit, and there is very little that you have said that I would quarrel with. Let me, however, try to interpret that history as I see it.

I believe the investment tax credit was imposed first in 1962 or thereabouts, and that it was discontinued in October 1966. And then, precisely 4 months and 1 day after the investment tax credit was discontinued, President Johnson recommended to the Congress that it be reinstated, and it was reinstated. Then it was discontinued again toward the end of 1969, and reinstated again at the end of 1971. All of this has truly been somewhat bewildering to the business community and to economists.

There is no difference of opinion between us on that at all. But let me indicate to you how I interpret what has happened.

I think what has hapened is that the Congress has struggled with this problem. The Congress has really tried to use the investment tax credit in a flexible way, as a business cycle tool, but it has not done very well. The timing has been poor. Now, the Board's suggestion is designed, really, to improve on congressional practice thus far. It is designed to use the investment tax credit as a business cycle tool, and to use it in such fashion that changes will be geared closely to the vicissitudes of the business cycle.

Now, I think it is a fair question: How will such a policy work in practice? Possibly, timing decisions would be no better under the plan sugegsted by the Board than they have been in the past. But I do believe that there is a good chance that the timing will be better.

In one way or another, Congressman Conable, we have to deal with the business cycle. Reducing incentives for investment at certain times is a good thing for the business community. In the absence of such a change, a boom may develop to an excessive height, thereby creating a lot of excess capacity, which will inevitably lead to low activity in the machinery and equipment industries after the boom breaks. So, if we can succeed in properly timing changes in the investment tax credit, we would cut down on the fluctuations in the capital goods industries. This would be a blessing in its own right, and the effects on housing would also be beneficial.

This is our reasoning. I realize that there are elements in it that are speculative, because how a policy really works in practice can never be known with certainty in advance.

Now, as for delegation of authority to the President, there I would repeat that under the Board's plan there would be no delegation as such. The Congress would be a full partner in any changes in the investment tax credit. But, the timing, you see, would be regulated so that the Congress, instead of debating a question of this kind for 6 months or a year, would be able to act within a period, let us say, of 60 days.

Representative Conable. Well, thank you. I have noted here your recommendation for variable interest mortgages. In this committee, we have become a little skeptical of cost-plus contracts generally and in, in effect, that is what you are giving the banks here, is it now, in a variable interest mortgage? If the cost of their money goes up, they can then raise their interest rates in the short term, and you are balancing that by requirements that if the cost of their money goes down they lower their interest rates. In the historical sense, I think there would be some reluctance on the part of a mortgagor to accept a variable interest mortgage because of the feeling that interest rates are much more likely to rise than lower. What about this cost-plus aspect of it? I recall a man writing me a while ago in great outrage about some savings bank in his area was building a magnificent big office building at great expense and he was terribly offended to find that as a depositor he had no control over this kind of expenditures, which he felt ultimately would affect the interest rates paid on his savings account. What would be the incentive for banks keeping their costs low if a variable interest mortgage were permitted?

Mr. Burns. Let me comment on this. I would not describe a variable rate mortgage as a cost-plus arrangement, largely because the very

terminology has emotional connotations of a kind that may impede objective analysis of the proposal. Putting that language aside, or retaining it if you will, let me say, first of all, that this proposal or this type of contract is now widely used in the business world. For example, term loans by commercial banks commonly provide for variations in the rate of interest.

Representative CONABLE. I know lots of banks that give only 5-year mortgages even though it is going to take 30 years to amortize the loan, so that they will have some flexibility in what they can charge for the later period of the mortgage.

Mr. BURNS. Now, next, the variable rate mortgage is already being used in some States to a minor degree. It has been tried abroad. I wish I could review for you foreign experience adequately. Unhappily I do not know enough to do this properly. But this is something if you were to consider a variable rate mortgage proposal seriously that you would want to look into pretty carefully. I would like to try to help you in any such endeavor.

Let me point out next that if I, as a homebuyer, were considering a variable rate mortgage, I would still have the option of electing a fixed rate mortgage. And If I elected a variable rate mortgage, I would do so, presumably, because I saw an advantage in doing so.

What would be my advantage? For one thing, I believe that the interest rate that I would get initially under a variable rate mortgage would be lower than the interest rate that I would get under a fixed rate mortgage. Second, I am not willing to accept the thought that interest rates are going to continue rising, that the trend must be upward. I would like to think that the trend of interest rates would be downward. That is my purpose, basically, in concerning myself with this whole area. That is one of the main reasons why I am so deeply concerned about the problem of inflation.

Senator Proxmire has commented on the high level of mortgage interest rates at the present time. Senator Proxmire pointed out that because of the high interest rate on mortgages, many families are priced out of the housing market, and the Senator is right. But, I do not see much chance, really, of bringing interest rates on mortgages down unless or until we get better control over inflation. I am very hopeful that we will do that. Let me point out, however, that if we do not, then our problem will not be confined to the residential building industry or to having an environment in which prospective home buyers can fulfill their aspirations for a good home. I think if we do not get inflation under control, our foreign trade, which is in grave difficulty, will be in still greater difficulty. I believe that the productivity of our economy will falter, and that the future of this country will otherwise not be what it can and should be.

In any event, the variable rate mortgage proposal would be an elective affair. People can choose it or not, depending on their judgment.

I recognize that a variable rate mortgage is a complicated instrument, one that many home buyers would be unable to grasp. Therefore, full disclosure and adequate counseling services would be essential if the Congress were to encourage this type of financial instrument.

Chairman PROXMIRE. Mr. Burns, I would like to get back very briefly to my suggestion which I made about the Federal Reserve

Board having authority to limit borrowing by big corporations, and it would be limited, and it would be moderate. They would be allowed to borrow, of course, but I would limit it to for example, 90 percent of a base period for Tier I corporations. And it would have a far less profound and far-reaching effect than you have at the present time through Wage and Price Controls. Also it would have far more bite than present monetary policy. You can have a much clearer picture of what effect that would have on the availability of credit and, also, on the inflationary activities than would the investment credit. The investment credit is a very blunt instrument with a whale of a lot of lag. Investment plans are made for a long period and when you come into an investment credit to give that kind of discretion to a corporation as to whether or not to go ahead with investment and take advantage of a tax rate, which they get if they go ahead with the investment, or not have that tax break available, it takes some time to work.

I happen to have supported the investment credit enthusiastically and have done so consistently, and still do. I am very sensitive that businessmen have criticized a policy that would put it on and take it off as you now suggest. If we use it as this kind of instrument, to fine tune our economy, I think you will have a lot of resentment and resistance, No. 1, and, No. 2, I think it is unlikely to have the kind of effect in a sufficiently limited period that would, that you would like to have to control inflation as compared to the capacity to simply limit the amount of borrowing. As I say, not eliminate it, of course, but limit it moderately.

Let me get back to our argument about the high rate of mortgages. They are lower than they were in 1969, 1970, and 1971. They are lower since you have become Chairman of the Board. There is no question about that. But, historically, they are very high, much higher than they have been in any other period. It is hard for me to understand why the rates have not come down more in view of the increase in the availability of credit from $36 billion to $46 billion and the mortgage credit has gone up that much, and you would think that that increase in supply, a 30 percent increase in supply, would result in a more substantial drop in 1971. The mortgage rates average 7.78 percent in 1971 and in 1972 they are 7.55 percent. Why is it, Mr. Burns, that with this 30 percent expansion in the supply of mortgage credit, and with the inflationary expectation being somewhat down, with wage and price controls and their performance, and yet we still have this very high level of mortgage rates?

Mr. Burns. The basic factors, as I see them, are, first, that while the supply of credit has grown abundantly, the demand for credit has also grown abundantly. And I need hardly tell you, Senator, that the Federal Government has been contributing on an extraordinary scale to the demand for credit.

Chairman Proxmire. Let me just document that point. That is a very good one, and I happen to have the Federal figures on this and the Federal Government has been raising their proportion in recent years of all borrowings either done directly or indirectly through governmental sponsored agencies, 10.6 percent in fiscal year 1969, 22.7 percent in 1970, 27 percent in fiscal year 1971 and 48.8 percent in fiscal

year 1972, a fantastic increase in the proportion of borrowing done by the Federal Government in relationship to all borrowing.[1]

So, you are absolutely right. I think that is a very critical point. And I am not sure what we can do about it, but I think it indicates that the Federal Government is a major contributor to this enormous demand, and the high levels of interest rates.

Mr. BURNS. I think that is true and I think a second factor is that inflationary expectations continue to be a major factor in money markets. Short-term interest rates have fallen very sharply from the levels that existed in 1969 and early 1970. Long-term interest rates have fallen much less. This is a very competitive market.

A major reason why the long-term interest rate has fallen so much less than the short-term rate is that investors, generally, continue to think that we are living in an inflationary environment. In such an environment, ivestors seek a premium on interest rates. And, actually, if you make allowance for the inflation that we have had, long-term interest rates are not particularly high I think that is literally true. For example, take an interest rate of 7 or 8 percent. If you allow for an inflation rate of 3 or 4 percent, and subtract that from the nominal contract rate, then the long-term rate is not abnormal, judging by historical yardsticks.

Chairman PROXMIRE. What you are saying is the wage and price control program, whatever other effects it has had has not seemed to have accomplished what many of us hoped it would which is to reduce the inflationary expectations, which are such a very important part of the inflation?

Mr. BURNS. I am not saying quite that. What I am saying is that even though inflationary expectations have been reduced, inflationary fears still persist.

Chairman PROXMIRE. What proportion would you say of the 7.5 percent mortgage rate in inflationary expectations?

Mr. BURNS. Oh, 2 or 3 percent anyhow. That would be my judgment.

I would add, Senator, that it is worth observing that at a time when prices and wages have continued to rise, interest rates have generally come down, so that the new economic policy has left its imprint on interest rates. But, it has not done it to the extent that you or I would like.

Chairman PROXMIRE. Yes, but the——

Mr. BURNS. And I do not think that we will succeed, really——

Chairman PROXMIRE (continuing). When you say interest rates have come down, although wages and prices have gone up, we have had a couple of elements here which seems to me should have had a better performance and one is that the productivity has increased so sharply and, especially, in recent months that wage costs have been stabilized, virtually stabilized, as you know. And that element of inflation should reflect itself in a somewhat lower interest rate. The other is while prices have gone up, they have gone up at a slower rate than they did last year or the year before. That should reflect itself

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[1] The statistical series used to calculate these percentages has been revised. The percentage for fiscal year 1972 will probably be closer to 30 percent when final numbers are available.

in lower interest rates. It has to some extent, but it seems to me it is a disappointing reflection.

Mr. BURNS (continuing). Yes, but long-term interest rates reflects not only current developments. They reflect primary expectations with regard to a long future, because loans are made 10 years, 20 years, or 30 years into the future.

Chairman PROXMIRE. Mr. Burns, I would like to get on one other subject, if I could, quickly. The Comptroller General made a very interesting proposal that we could save between $2.5 and $5 billion over the next 5 years if we provided for direct Government loans for subsidized housing, instead of indirect Government guaranteed loans. The difference in the rate paid would be that much and, of course, he is a man of great integrity and his people seem to be very skilled in this area.

It is such an inviting opportunity to save money that I would like to have your views on two elements of it. One, the inflationary impact, if any. In your view, would it be more inflationary or would it have any inflationary effect whether we financed the subsidized housing program through direct Government loans as compared with this indirect method we are using now; and, two, whether you would agree that we would have a substantial savings in this area, not pinning you down to the amount?

Mr. BURNS. Well, I would like to study Mr. Staats' proposal which I have not had the opportunity to do.

Putting magnitudes to one side and directing myself to your general question, I would point out that I have some serious doubts about a proposal of this sort. If the Comptroller General's proposal were adopted, it would lead at once to an increase in Federal spending, an increase in the Federal budget, and I think that this would have an adverse psychological effect on the financial community.

Chairman PROXMIRE. May I ask, is it not true that the so-called increase is very much of an illusion because it is simply a different bookkeeping procedure? Are you saying that the bookkeeping procedure, and you may well be right, would have a psychological effect on the community because you are dead right, the budget would be bigger. It would be bigger, by I think he said, $3 billion a year, the deficit would be larger. However, the overall effect, as far as the taxpayer is concerned, would be no different except that this method of direct financing would be cheaper and would save the taxpayer money in the long run.

Mr. BURNS. That may well be.

Chairman PROXMIRE. Could we do it outside the budget.?

Mr. BURNS. I do not see how you could do it outside the budget.

Chairman PROXMIRE. Well, we do a lot of things outside the budget, some of which you very strongly have opposed. But, we do them.

Mr. BURNS. Well, I think that financing that we do outside of the budget should be looked at very closely. The financial community watches that.

At the present time it is imperative that budget expenditures be restrained. That is why I fought so hard for an expenditure ceiling in recent months.

Chairman PROXMIRE. Look at the dilemma you put us in, Mr. Burns. You see, these are loans, they are not expenditures in the usual sense. They are repayable with interest. They have good solid collateral and we are put in the position where we have to waste, apparently, on two programs, 235 and 236 programs, $2 to $5 billion. Now, it just seems to me ridiculous for us to throw billions away and you are more conscious of waste than the overwhelming majority of people.

Mr. BURNS. Let me tell you a story, Senator. I remember years ago talking to my mother who told me about making a purchase of a new refrigerator on the installment plan. I said to my mother, "This is terrible. Why are you doing that? You have money in the savings and you get 3 percent interest on it. (That was the rate she was getting at the time). And you will be paying, perhaps 12 or 20 percent interest when you borrow on the installment plan."

Now, my mother was an extraordinarily good, practical economist and she replied, "My dear son, I know all of that." I said "Well, then, why are you doing it?" Her answer was, "I am doing it because it is good economics." I sighed, "I don't understand that." And she finally said "Well, I know your father better than you do. If we borrow the money, your father who is a good man, and does not want to be in debt, will work harder to make sure that it is repaid. If, on the other hand, we draw on our savings account your father will be less energetic."

Now, there are many considerations that we have to keep in mind in reaching economic decisions. At a time such as the present, anything that serves to increase the magnitude of the Federal budget, as we measure it, would have a large psychological effect on the financial community, and an adverse effect on interest rates.

But, that is not my only reason for being doubtful about the proposal of the Comptroller General. Other questions come to mind. If the Federal Government is to go into the market, to borrow funds, and then lend these funds to home buyers, why not do that for small business, why not do that for medium-sized firms, and so on?

Chairman PROXMIRE. Could I interrupt by saying we do that for small business now, to some extent. We are just saying we have these programs anyway, they are Federal programs they provide a Federal guarantee at a substantial Federal subsidy.

Mr. BURNS. I have some questions about anything that serves to weaken our private financial institutions or their incentives. I would like——

Chairman PROXMIRE. Would you like to see us eliminate the guarantee?

Mr. BURNS. No, I do not want to do that. I think the guarantee serves an important function. But, I would like to put our financial institutions in the position of being coinsurers, coguarantors, to a larger extent, so that they would have an incentive to administer these loans in a more efficient manner.

Chairman PROXMIRE. Do you think it is worth paying $2 billion or $5 billion for that kind of psychological reassurance?

Mr. BURNS. I am not going to comment on magnitudes because I do not know enough about them to do so.

Chairman PROXMIRE. Certainly billions of dollars.

Mr. BURNS. You know, there is an element of illusion here. Senator, that we should be conscious of. To be sure, the Federal Government can borrow today at a lower rate of interest than can a private corporation. That will be true tomorrow as well and also the day after tomorrow. However, if the Federal Government goes into the market and borrows on a larger scale, this will release forces making for higher interest rates, so that the level of interest rates may be raised. This is a consideration that we must not overlook.

Let me make another observation, Senator. If the Federal Government begins——

Chairman PROXMIRE. Let me just point out, though, Mr. Burns, that would be displaced by the private borrowings which would be reduced if the Federal Government would simply do it by direct borrowing instead of by guaranteeing the private borrowing. There would be no increase in borrowing. You would have the same level of subsidized programs.

Mr. BURNS. I realize that. But, confidence of the financial community in the future of our financial markets would be significantly influenced by such a policy.

Let me point out still another factor that I think the Congress should keep in mind in evaluating a proposal such as the Comptroller apparently made. If the Federal Government is going to make loans directly, then the Federal Government will be faced with the task of administering these loads. And if the Federal Government is going to administer these loans, what do you think will happen to the delinquency rate, and what do you think will happen to the foreclosure rate? Is the Federal Government going to foreclose mortgages on homes of poor families?

Chairman PROXMIRE. Well, we have experience with that now. The Farmers Home Administration has the same kind of a program. They make direct loans. Their foreclosure rate is better than the rate that we have in the private market and Federal guarantees are substantially better.

Mr. BURNS. I know nothing about that, but we are talking now about a much enlarged program. I would want to think very carefully about the Federal Government becoming a direct mortgage lender and what that might imply for delinquency rates and what that might imply for the foreclosure rate.

Chairman PROXMIRE. You see, one of our problems we are very concerned with is the present rate of foreclosures under 235 and 236 with private financing. It goes up to 20 percent, 2 to 20 percent, depending on the area.

Mr. BURNS. Well, Senator, the foreclosure rate might come down under Mr. Staats' proposal simply because the Federal Government would not have the guts to foreclose on mortgages. That would be very unpopular.

Chairman PROXMIRE. What we found is that the foreclosures because they vary so much, that it is not a matter of guts, but it is a matter of good management, and a matter of recognizing the kind of people who should be in these programs. It is a matter of counsel-

ing the people who are in them and it is a matter of training your personnel so that they exercise a far better judgment in making their evaluations of the properties and so forth.

Mr. BURNS. Well, you——

Chairman PROXMIRE. We have a situation in Milwaukee where our foreclosure rate is extraordinarily low although the credit has been made as widely available as elsewhere, whereas in Detroit it is extraordinarily high, 10 times as high in Detroit as Milwaukee. Why? They have exactly the same program, Federal, privately financed, and federally guaranteed. The problem is HUD management is much better in Milwaukee than in Detroit. The foreclosure is a matter of the competence and ability of the people who are making the loans and it is going to be a Federal official in any event under either program.

Mr. BURNS. Well, I would place greater confidence in the ability of private financial institutions to manage lending programs than I would in the Federal Government to do so.

Chairman PROXMIRE. All right, sir. I do have one other question. This relates to your function as the man who has more authority over credit than anyone else.

How about as an alternative to direct control of interest rates under the wage and price control program, considering the control of bank profits? I cannot understand why banks and other lenders should not be subject to the same profit margin guidelines that are applied to all other corporations and businesses. There are a number of serious problems with profit margin controls. But, as long as we have these profit margin controls for businesses generally, why should they not also be applied to banks and why should banks be free to earn a higher profit, while the rest of industry is controlled? Total bank profits in 1968 were $3.4 billion. In 1971, they were $5.4 billion and that is a 53 percent increase, a remarkable increase in a period when nonfinancial corporations suffered a drop in profit. Now, we have a situation where we are controlling the firms that have suffered the drop and we are letting the financial institutions go along with no controls except some jawboning in the area of interest rates.

Mr. BURNS. Let me make just two brief observations. First, when you talk about profits of banks or business corporations and about changes that have occurred, you may get one result when you choose one base year, as you have done, and you will get a different result when you choose another base year. For example, if you had chosen 1970 as the base year instead of 1972, you would have reached a very different conclusion.

Second, let me make a far more important point. I think we have a highly competitive money and capital market in this country. During the last 2 years when prices and wages have gone up, interest rates have come down. Many interest rates have come down very materially.

Having said all of this, I do think that in a period when prices and wages are under control, administered interest rates, in contrast to market interest rates, are rightly a subject of governmental concern. The committee on interest and dividends has therefore sought to moderate changes in the level of administered interest rates. We have done

that in various ways. One of the most important things we did was to fix a guideline on dividends. By restricting dividend increases to 4 percent, which is a very modest figure, we have made it possible for corporations to retain profits to a larger degree. Actually, the payout of dividends this year will be approximately $2 to $2½ billion less than it would have been in the absence of the dividend guideline. Therefore, our business corporations have been borrowing to a lesser extent than they would have otherwise, and interest rates are significantly lower than they would have been in the absence of the dividend guideline.

Chairman PROXMIRE. What I want to get into, and it is not directly germane to the housing problem, but I did want to ask that question. We want to get into much more detail when the Banking Committee considers what to do with the Wage and Price Control Act. As you know, that expires in a few months.

Congressman Conable.

Representative CONABLE. Well, on this last point I do not know. It does reduce the flexibility of the typical investor in a system that depends on the mobility of capital. He is forced in effect to reinvest his money in the corporation in which he holds stock, and for the long run it is not a desirable thing, is it? You are looking at it purely through the point of view of its impact on the interest rates.

Mr. BURNS. Congressman Conable, let me give you the history of the dividend guideline. The committee on interest and dividends, once the control program went into effect, moved promptly to establish the modest 4-percent dividend guideline. We did it primarily to influence the thinking of the Pay Board. We wanted to set an example of restraint and moderation for the Pay Board, and we were successful in that.

Representative CONABLE. So that, and not interest rates, was your primary motivation?

Mr. BURNS. That is right. Our secondary motivation was the indirect influence on interest rates, but by far the most important element in our thinking was to set an example of moderation for the Pay Board. And I have reason to think we were successful.

Representative CONABLE. Mr. Burns, I do not have any other specific questions in this area. But, I think it would be——

Mr. BURNS. May I say one more thing?

As a long-run measure, I think this is very bad, and I hope we will not continue it.

Representative CONABLE. All right. Well, that leads into the last opportunity I want to give you here before the committee and, that is, to comment generally about the fiscal decisions facing us this year, if you wish to. If you would prefer not to discuss things, why I think it is entirely up to you because this hearing relates primarily to housing. Nevertheless, fiscal matters affect housing more than academic concerns. There really is a triad of fiscal questions that the Congress is going to have to face. They are all related. One has to do with the imposition of a $250 billion or some other expenditure ceiling. The second has to do with the extension of wage and price controls. The third has to do with more equity in Government income and outgo, either through substantial cuts in Government expendi-

tures, something that apparently is very difficult for the Congress to do, or through the imposition of new or increased taxes.

Now. would you like to establish any priorities for us here? As I said, these are all related. Would you like to comment generally about what you would like to see the Congress do with respect to these related fiscal questions?

Mr. BURNS. Well, one way or another I think we should try to keep expenditures this fiscal year at or even below $250 billion. If we succeed, this will have a beneficial effect on expectations with regard to inflation and, therefore, also on interest rates.

As for the continuance of an incomes policy, I think that for 1973 an effective incomes policy is essential. We ought to set a goal of getting the rate of inflation down further, and, if we succeed, we can rid ourselves of the whole apparatus at the end of 1973. That would be my very sincere hope.

As for greater equity, that is something that the Congress is always concerned with, and should be concerned with. The Congress will be considering proposals for tax reform, and I have no specific suggestions to make to the Congress now.

Representative CONABLE. Tax increases, and not just tax reform? I realize that one would have to follow the other.

Mr. BURNS. I would hope very much that no increase in taxes would take place this coming year. If we keep expenditures under good control, I do not think it will be necessary.

On the other hand, if we do not, and if the expenditures are permitted to mount, then I see no choice before the Congress except to raise taxes. But, I think we can avoid it and we should, do so.

Representative CONABLE. We have a cumulative deficit, apparently, for the past 4 years in excess of $110 billion and there comes a point where this sort of thing cannot go on.

Mr. BURNS. It can go on, unfortunately. That is the trouble.

Representative CONABLE. Well, the question is: How long should we continue to try to cut expenditures back and when do we reach the point where we have to grasp the nettle by the stinging end, raising taxes?

Mr. BURNS. Well, I keep worrying and I keep dreaming. In fact, I spend some sleepless nights worrying about this. The thought has occurred to me at times that it might be a good idea to have a brief freeze on expenditures. It might be a very healthy thing for this country. And I hope that the distinguished chairman of this committee will use his fine energy and talents in such a direction, along with his colleagues on this committee and in the Congress.

Representative CONABLE. Well, we all share this responsibility I think.

Chairman PROXMIRE. I would agree. I think the level of $250 billion for the ceiling for the fiscal year 1973 was too generous, and it should be $245 billion; $245 billion is where the full employment budget is in balance; $250 billion is an inflationary level. At any rate, getting $250 billion is going to be a very difficult thing to do right now, we all know, with the built-in increases. Do you realize when you say freeze expenditures, and there are some expenditures which because

of the built-in effect, social security pensions which just cannot be frozen, and the Congress, rightly or wrongly, increased them. And we have a situation where we are going to have a very substantial increase next year compared to fiscal year 1974, compared to fiscal year 1973. This is true of veterans pensions and this is true of a number of other areas. Some people have said that it would be draconian. It would be very tough to limit the budget to say, $270 billion this coming year, or do you not want to give us a figure that precise, $270 billion in 1974; does that seem like a reasonable goal?

Mr. BURNS. Too high, in my judgment.

Chairman PROXMIRE. Too high?

Mr. BURNS. Yes.

Chairman PROXMIRE. Have you taken a look at the built-in increases?

Mr. BURNS. I have.

Chairman PROXMIRE. Have you had a chance to read an article in the November Fortune, entitled "The Federal Budget Is in Trouble"?

Mr. BURNS. No, I have not.

Chairman PROXMIRE. I recommend that to you. It is a splendid article because what it does is analyze the uncontrollable expenditures and others.

And would you say, if we are successful in holding down spending to below $270 billion that military spending should take its share of the reduction?

Mr. BURNS. Senator, I have testified before your committee before and I have said time and time again that, in my judgment, spending can be cut in every direction. I certainly do not want to exclude the military.

Chairman PROXMIRE. You do think it could be cut in the military area, too?

Mr. BURNS. Why, of course it can. All that is necessary is the will, and that is the main thing that has been lacking.

Chairman PROXMIRE. Yes. But you see, on the other hand, they tell us if we cut military spending that we are reducing our capability of meeting our international responsibilities and we are reducing our defense capabilities vis-a-vis Russia, and that it is our responsibility——

Mr. BURNS. That depends on where you make the cuts. We have military bases that are useless from any military standpoint, and they could be eliminated. There is fat in the military budget just as there is in every other budget.

Chairman PROXMIRE. Let me ask you about one other phase of this. In answer to Congressman Conable, you said that you are for an effective incomes policy, which I presume you think we should have longer than the end of 1973, but that you felt that controls, if we had a good performance, could be eliminated by the end of 1973?

Mr. BURNS. I do. Actually, I doubt if controls can have a much longer life.

Chairman PROXMIRE. All right. In view of that, would you suggest that we might limit the extension of the wage and price control program to calendar 1973, rather than extend it for a year to April 30, 1974?

Mr. BURNS. That is a difficult question, Senator, because I think that a standby authority, which is all that the Economic Stabilization Act really provides. is important.

Chairman PROXMIRE. Once again, we give up to the President a great power if we let him be the one to end this instead of doing it ourselves.

Mr. BURNS. That is a very relevant observation. The difficulty, you see, is that now we have these controls. If we were to limit them by legislation through the end of 1973, then I think that the controls would erode by the middle of 1973. Staff would disperse and there would be evasions here and there, all on the expectation that the program is ending. So, in effect, the end would really come sooner, and that is something to bear in mind.

Chairman PROXMIRE. It is always a problem, though, no matter when you end it.

Mr. BURNS. Yes.

Chairman PROXMIRE. Do you want to give us a figure on the 1974 ceiling? This would be very helpful to us. The Congress, under the proposal of Senator Mansfield, at least, would consider putting a ceiling into effect independently, and I am sure you would not object to that, and I do not think the President would either.

Mr. BURNS. This is a ceiling on expenditure?

Chairman PROXMIRE. Yes.

Mr. BURNS. Let me merely say that I would like to see this ceiling to be lower than the kind of figures that are being discussed. I hesitate——

Chairman PROXMIRE. It would be very helpful if you would give us a figure; $265 billion?

Mr. BURNS. Well, I would like it lower.

Chairman PROXMIRE. $260 billion?

Mr. BURNS. I am not going to bargain with you, Senator.

Chairman PROXMIRE. Thank you very much, Mr. Burns.

As usual, you have been most helpful and I want to apologize if my assertions in my opening statement seemed to be contentious. I did not mean it that way at all. I think we had a very useful dialogue, and you did your usual outstanding job.

Mr. BURNS. Well, thank you very much, Senator.

Chairman PROXMIRE. Our next witness is Mr. Stanley Waranch, president of the National Association of Home Builders. We are delighted to have Mr. Waranch here and he is a fitting witness to windup our hearings.

Mr. Waranch, as you know, Mr. Burns had a short prepared statement. Your prepared statement is considerably longer and we have a little buzzer that we ring, but I certainly would not ring it on you as the hour is late. I understand you could abbreviate your prepared statement. Could you do it in 10 minutes for us?

Mr. WARANCH. I will, sir.

Chairman PROXMIRE. We would appreciate it and may I say that the entire prepared statement, which is an excellent one, will be printed in full in the record, so it will be available to all of the members of the committee and the Congress.

STATEMENT OF STANLEY WARANCH, PRESIDENT, NATIONAL ASSOCIATION OF HOME BUILDERS, ACCOMPANIED BY GEORGE C. MARTIN, FIRST VICE PRESIDENT; NATHANIEL H. ROGG, EXECUTIVE VICE PRESIDENT; MICHAEL SUMICHRAST, CHIEF ECONOMIST; HERBERT COLTON, GENERAL COUNSEL; AND CARL A. S. COAN, JR., LEGISLATIVE COUNSEL

Mr. WARANCH. I hope you will not start my 10 minutes until I introduce all of these distinguished gentlemen with me, because that may take me a couple of minutes.

Mr. Chairman and members of the subcommittee, my name is Stanley Waranch, and I am a home builder from Norfolk, Va. I appear here today as president of the National Association of Home Builders. I have with me, on my immediate right here, Mr. Herbert Colton, our general counsel, and on his right, is Mr. George C. Martin, our first vice president from Kentucky, and on his right Mr. Michael Sumichrast, our chief economist. On my left is our executive vice president and our distinguished economist, Nathaniel H. Rogg, and on his left is our legislative counsel, Mr. Carl A. S. Coan, Jr.

I appreciate very much this opportunity to appear before you today and discuss with you our views on Federal Housing policies and subsidies.

Housing needs have been dealt with by Congress more and more over the past 40 years and the outlines of a national policy have emerged from these congressional actions. In the thirties the Federal Government was initially concerned with preventing massive foreclosures and reviving a practically dead housing construction industry. This concern was broadened in 1949 to recognize that every American family is entitled to a decent home and a suitable living environment. This national housing goal was quantified in the 1968 Housing Act. As I recollect, it was the chairman of this subcommittee who added this housing goal to the 1968 act.

However, it is one thing to have a goal to be met in a definite number of years. It is another to recognize the need to allocate the necessary resources toward meeting that goal and to undertake the actions required to assure the proper allocation of those resources.

The great bulk of the very substantial addition in recent years to the Nation's supply of low- and moderate-income housing has been provided under HUD's 235 and 236 programs, first enacted in 1968. For the first time the Nation has effectively undertaken, on a large scale, to deal with the housing needs of low- and moderate-income families.

Generally these programs have performed well. However, as hundreds of thousands of units have been financed, some problems have arisen. We share the subcommittee's concern about these problems. We are additionally concerned that the programs have been the subject of unjustified and unreasonable attacks.

The 235 and 236 programs have borne the main brunt of the blame for troubles and abuses that have occurred in connection with HUD's housing programs. The truth is that the defaults and foreclosures have largely occurred in connection with nonsubsidized, existing housing insured under the FHA 203 and 223(e) programs.

The few scandalous activities in connection with the subsidized programs have almost entirely involved existing housing financed under the 235 program. In these situations, inadequate inspections and appraisals by FHA personnel have resulted in low-income families buying homes—many needing substantial repairs—at exhorbitant prices. This is a most serious problem. However, it does not result from basic deficiencies in the 235 program, but from a failure of certain HUD offices to properly carry out HUD's prescribed procedures.

The 235 and 236 programs have, in fact, been highly successful. They have provided homes for hundreds of thousands of families who otherwise would not have been able to obtain adequate housing at a cost they could afford. To date, 500,000 dwelling units, under each program, have been constructed, placed under construction, or had subsidy funds reserved for them. Furthermore, over 90 percent of the families who have purchased homes with assistance under section 235 are current in their mortgages. In the case of the 236 program, over 95 percent of the mortgages are current.

Another encouraging fact concerning the 235 program is the experience on income recertifications. For those families whose incomes have been recertified so far, over 60 percent have experienced a rise in income sufficient to permit a decrease in their subsidy. Further, about 4 percent have gone completely off subsidy assistance. These and other data concerning the 235 and 236 programs are set out in an attachment A to my prepared statement.

Two principal reasons for the abuses in HUD's housing programs are HUD's attempt to operate expanded volume programs with fewer personnel and HUD's continual disruptive internal reorganizations. We firmly believe that the present housing subsidy programs represent the best method so far designed to meet the needs of the Nation's low- and moderate-income families. They are not perfect. They could be improved, but they work.

In reaction to the widespread and erroneous impression given by many press reports that the present programs are not working, some have suggested their abandonment for a housing allowance program. Others have proposed a housing allowance on the premise that it would be significantly less expensive or that it would avoid long-term budgetary commitments.

We doubt very seriously that a nationwide housing allowance program would be less costly than the present programs. Further, it is a delusion to look upon housing allowances as a means of extricating the Government from long-term commitments.

Once the Federal Government began providing housing allowances to American families it would be impossible to abandon or significantly curtail such a program. The probable costs of such a program were studied for us by the Real Estate Research Corp. under the supervision of Mr. Anthony Downs. Mr. Downs concluded that a housing allowance program would be more expensive than the present approach and could cause many other problems. I should like to offer a copy of that report for insertion in the record, if you so desire, Senator. It is quite thick.

Chairman Proxmire. Yes, without objection, we will hold that for the record.[1]

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[1] A copy of the report submitted for the record by Mr. Waranch may be found in the committee room files.

Mr. WARANCH. Thank you, sir.

One of the major problems of a housing allowance program is its incapability to increase the supply of moderate-priced housing.

Chairman PROXMIRE. May I say, I do not think you asked me to have that printed in the record, but it will be available if anybody wants to see it, and it will be held in the committee files.

Mr. WARANCH. Thank you, sir.

One of the major problems of a housing allowance program is its incapability to increase the supply of moderate-priced housing. A corollary defect is the inflationary impact on the price of existing housing.

In 1970 the Congress provided legislation to study these and other implications of a housing allowance program. Unfortunately, HUD has only barely begun this experiment.

I should like to turn now to the compendium of papers submitted to this committee on housing subsidies. Our staff has studied these papers and has prepared a brief analysis of some of their major points, and this analysis also is attached to the prepared statement as attachment B. But, I would like to comment briefly on two of the papers.

Mr. Henry Aaron's paper on "Federal Housing Subsidies" includes among the so-called subsidies the "Special Tax Benefits for Homeowners," available for Federal taxpayers under the Internal Revenue Code. He measures that amount against the considerably lesser amounts available under the various direct housing subsidy programs. Naturally, the comparison indicates a disproportionate level of subsidies available to middle- and upper-income families.

It is difficult to perceive the basis for this comparison. While the ability to deduct interest and tax payments from one's gross income certainly provides a significant tax benefit, they have not normally been considered a subsidy and were not included in the Internal Revenue Code with the intent of housing subsidization.

Mr. Aaron also states that the existing system of housing subsides is excessively costly. This conclusion appears to rest heavily upon the premise that lower income families could be housed in socially acceptable housing at approximately $600 a year cheaper under a housing allowance system than under the 235 program.

We disagree, especially in light of Mr. Downs' study and the fact that Mr. Aaron's conclusion is based on 6-year-old data.

I would like to make just two comments on the article by Mr. James Wallace. First, tax benefits available to the owner of section 236 housing do not substantially differ from those available to the owner of nonsubsidized housing.

Second, the particular example chosen by Mr. Wallace involving a 236 rehabilitation project is deficient in representing this type of project. We believe Mr. Wallace has set up a straw man.

With respect to mortgage credit fluctuations, no one can dispute the fact that the Nation periodically suffers severe disruptions in housing production caused by a lack of mortgage credit. The real question is how do we deal with this problem.

As the industry felt the crunch of tight money and high interest rates in 1969, we urged the Congress to take quick remedial action. The Emergency Home Finance Act of 1970 faced up to some of those

problems. Most legislation, however, has dealt with symptoms rather than basic problems.

We were hopeful the President's Commission on Financial Structure and Regulations, known as the Hunt Commission, would recognize that our present financial structure works severe inequities on housing finance and availability.

Unfortunately, its far-reaching recommendations, if adopted, would leave housing considerably worse off than it is now. We have attached to the prepared statement, attachment C, the summary analysis of the Hunt Commission report by an NAHB Task Force.

Among the types of actions we believe are needed are—

The requirement that the Federal Reserve System support housing finance through its open-market operations; the requirement that private pension funds, in return for their favored tax status, invest a reasonable portion of their vast resources in housing; and the institution of a National Development Bank to provide funds for housing purposes.

We have been asked to comment on the recent study of housing finance by the Federal Reserve staff. We have had difficulty in ascertaining what firm conclusions the study recommends. It points out all sides of the various aspects of the problem and leaves one wondering in which direction to go.

Its principal point seems to be that housing will be able to obtain its appropriate share of available credit only if all ceilings with respect to the cost of mortgage money are removed. This could assure the availability of money for housing but at a price too high for most Americans to pay.

The study by the Federal Reserve staff, while recognizing the importance of housing in the social sense, fails to support policies which would give proper priority to financing those housing needs.

Thank you for the opportunity to appear here today. We appreciate the committee's concern about adequate housing for our Nation's families and hope that you will call upon us if we may assist in any way possible in this common endeavor.

(The prepared statement of Mr. Waranch follows:)

PREPARED STATEMENT OF STANLEY WARANCH

Mr. Chairman and members of the subcommittee: My name is Stanley Waranch and I am a home builder from Norfolk, Virginia. I appear here today as President of the National Association of Home Builders. Our association has a membership in excess of 65,000 in 536 associations throughout the 50 states, Puerto Rico and the Virgin Islands.

I have with me Nathaniel H. Rogg, our Executive Vice President and one of the nation's leading housing economists, as well as Michael Sumichrast, our Staff Vice President—Chief Economist, Herbert Colton, our General Counsel, and Carl A. S. Coan, Jr., our Staff Vice President—Legislative Counsel.

I appreciate very much this opportunity to appear before you today and discuss with you our views on Federal housing policies and subsidies. The Subcommittee has undertaken a major task, and I compliment it on its initiative and willingness to delve into this highly complex and often controversial area. Although there is much that is of value in our present Federal housing policies, there are also many areas that are in need of improvement and updating. I should hope that out of these hearings will come recommendations as to how the nation is to deal better with the obvious need to assure that all its citizens are adequately housed.

NATIONAL HOUSING POLICY

These housing needs have been dealt with by the Congress more and more over the past 40 years and the outlines of a national housing policy have, to a great extent, emerged from these Congressional actions. The Congress and the Federal government have moved from an initial concern with preventing massive foreclosures and reviving a practically dead housing construction industry in the early 1930s, through the recognition that every American family is entitled to a decent home and a suitable living environment in 1949, to the qualification of that 1949 goal in Title XVI of the Housing and Urban Development Act of 1968.

As I recollect, it was the Chairman of this Subcommittee who added this Housing Goals title to the Act. NAHB strongly supported that action and I want to compliment the Chairman and the Congress for inserting into that Act what our nation's responsibilities and goals towards housing were and should continue to be. I believe those goals, and the mechanism for an annual review of their progress, to be one of the Congress' most important legislative accomplishments, as far as housing is concerned.

The 1949 goal of a decent home and a suitable living environment, given true substance for the first time in Title XVI, along with the many programs contained in the 1968 Act designed to make a reality of that goal, I believe form the basic housing policy of this nation. However, establishing that policy in itself did not, and cannot, assure that our housing goals will be achieved.

In 1968 we had just emerged from the severest housing depression since the second World War, and, though none of us knew it at that time, we were headed in a short time toward one almost as severe. The housing depression of 1969–1970 probably would have been more severe than the one of 1966–1967 without the many aids and programs provided in the 1968 Act. Also, if it had not been for the annual reports required by Title XVI of that Act to assess our progress toward meeting our goals, we would be less able to analyze the reasons why we are, or are not making progress.

It is particularly appropriate that this Subcommittee should be concerning itself with an assessment of our nation's housing policies, in view of its responsibility to delve into priorities which the Government must set with respect to the use of its resources. Although these resources are vast, they are not limitless. Decisions, of course, must be made as to where they are to be allocated and what priorities shall govern this allocation.

Adequate shelter is one of man's basic needs. In any ordering of governmental priorities, it is imperative that the nation's housing needs stand near the top. This too often has not occurred. When it has occurred, it has frequently been on an on-again, off-again basis. We believe this is partially responsible for the wide fluctuations in the supply of adequate mortgage funds at reasonable interest rates and consequently in housing construction volume, one of the particular matters which this Subcommittee is studying.

If the Federal government had maintained consistent concern with housing as a major national priority, I believe, that over the years it could have taken steps to assure that the housing sector would not be the major victim of variations in the economy and the government's efforts to deal with these variations. It is one thing to have a goal to be met in a definite number of years, it is another thing to recognize the need to allocate the necessary resources toward meeting that goal and then to undertake the actions required to assure the proper allocation of those resources.

As a result of the policies and programs laid down by the Congress through the years, and most especially in 1968, the Federal government has had available to it over the past four years the means and impetus to deal much more effectively with the nation's housing problems. The Administration, with the support of the Congress, has used these programs to move the nation well along the road toward meeting the 1968 goals.

While housing production in 1969 and 1970 was considerably below the levels needed to meet the ten-year, 26-million unit goal, 1971 and 1972 have seen new records in each year. Last year we started almost 2.1 million new housing units and this year we should start close to 2.4 million units. For the first time a substantial portion of this production has been available to low and moderate income families who, without Federal assistance, would not have been able to obtain decent housing. This provision of about 1.3 million units of low and moderate income housing is one of the most important achievements of the past four years.

HOUSING SUBSIDY PROGRAMS

Although the nation as a whole is much better housed than ever before in its history (only one unit in 12 being considered substandard in 1970 according to the Census, compared to 37% in 1950), there are still millions of families who are living in substandard housing, or in overcrowded quarters, or in housing for which they pay excessive portions of their meager resources. For the first time the nation has effectively undertaken, on a large scale, to deal with this problem. The decision to do this represents one of the most important aspects of our national housing policy.

The great bulk of this very substantial addition to the nation's supply of low and moderate income housing has been provided under HUD's 235 and 236 programs, first enacted in 1968. These programs have performed the job that they were designed for. Generally they have performed it well. However, as hundreds of thousands of units have been financed. Some problems have arisen. This I know, the Subcommittee is quite concerned about.

We are also concerned, because we believe that these programs are very effective mechanisms for housing those who could not otherwise afford adequate housing. We are also concerned that these programs have come under severe and unreasonable attack over the past year. The press and the Congress have focused a great deal of attention on certain deficiencies and difficulties experienced in the programs. These have been relatively few in number. At the same time, little attention has been devoted to the two programs' many accomplishments. As a result, many have begun to question the validity of the programs and whether they have really served those for whom they were intended. Others have suggested abandoning them with or without some effective alternative means of meeting the housing needs of the low and moderate income. This is most unfortunate, to say the least.

The 235 and 236 programs have borne the main brunt of the blame for troubles and abuses that have occurred in connection with HUD's housing programs. The truth is that the widespread defaults and foreclosures in Philadelphia, Detroit and elsewhere have not generally involved these programs. Instead, they have largely occurred in connection with non-subsidized, existing housing insured under the FHA 203 and 223(e) programs.

The few scandalous activities in connection with the subsidized programs have almost entirely involved existing housing financed under the 235 program (not new construction). In these cases, inadequate inspections and appraisals by FHA personnel have resulted in lower income families purchasing homes at exhorbitant prices, many of which have been in need of substantial repairs. In some cases these families have been stuck with homes which did not even meet the minimum housing code of the community.

This is a most serious problem and one which must not be allowed to recur. However, it does not result from any basic deficiencies in the 235 program, but rather from a failure of certain HUD offices to properly carry out HUD's prescribed procedures. HUD has taken steps to prevent the recurrence of such abuses and they appear to be working.

The 235 and 236 programs have, in fact, been highly successful. They have provided homes for hundreds of thousands of families who otherwise would not have been able to achieve adequate housing at a cost they could afford. To date, almost 500,000 dwelling units, under each program, have been either constructed, placed under construction, or had subsidy funds reserved for them. This is an outstanding record for the four-year period in which these programs have been in operation. In fact, almost as much housing has been produced for low and moderate income families under these programs during this period as had been produced in the preceding 30 years.

I believe it is important that the successes of these programs receive at least equal attention with the relatively few deficiencies that have occurred. For instance, over 90% of the families who have purchased homes with assistance under Section 235 are current in their mortgages and are neither in default nor have had their property forclosed on them. In the case of the 236 program, over 95% of the mortgages are current.

This is certainly an outstanding record, considering the more precarious financial status of the families occupying this housing. The Congress recognized this in 1968, when it also established a Special Risk Insurance Fund because of the

expected higher risks, with the understanding that it would not be actuarially sound (as the other FHA insurance funds must be) and the recognition that there would probably be some need to go to the Treasury on occasion to fund losses not covered by the mortgage insurance premiums. To date there has been little need of this, however, and a large portion of the losses experienced by the Special Risk Fund have arisen in connection with the non-subsidized 223(e) program.

Another encouraging fact concerning the 235 program is the experience to date on income recertifications. For those families whose incomes have been recertified so far, over 60% have experienced a rise in income sufficient to permit a decrease in their subsidy. Further, about 4% have gone completely off subsidy assistance. This, I believe, is a decided indication of the value of the program. These data and other data concerning the 235 and 236 programs are set out in an attachment to my statement.

At this point, I believe it is important to indicate two of the principal reasons for the abuses that HUD has experienced in its housing programs. HUD, until recently, has been attempting to operate with less personnel than it had four years ago: while, at the same time, dealing with a vastly expanded volume of housing—both subsidized and unsubsidized.

Additionally, the Department has gone through an almost continuous series of reorganizations in the past three years. These reorganizations, perhaps desirable from a theoretical viewpoint, have unfortunately caused considerable chaos in the administration of the housing and other HUD programs and left many personnel with the sense of being adrift, not sure day to day of what they will be doing, or in what part of the country they will be working. Morale has suffered accordingly.

In some parts of the country, FHA processing stopped completely for weeks and even months and many builders, growing tired of excessive delays, threw up their hands and abandoned their efforts to work under the FHA programs. The converse of this has seen HUD pushing applications through without proper review and inspection of properties and the taking advantage of the government by those who seek such opportunities in places of confusion.

The Department in recent months has become more aware of these troubles and it has taken steps to correct them. Additionally, HUD in this fiscal year received funds to increase its staff, especially in FHA, to a level more able to deal with the volume of business. The situation has improved, but it has a way to go yet.

We firmly believe that the present housing subsidy programs represent the best method designed so far to meet the housing needs of the nation's low and moderate income families. That is not to say that any of these programs is perfect, or could not stand perfecting changes. Some people have suggested that the Federal government ought to abandon these present housing assistance programs and adopt, instead, a housing allowance program.

Many of those who have put forth this proposal appear to have done so in reaction to the widespread and erroneous impression given by many press reports that the present programs are not working and have, in fact, turned out to be failures. Others have proposed the housing allowance approach on the premise that it would be significantly less expensive than the present approaches and the government would not be locked into long-term contract commitments as it is now under the present programs.

As I have pointed out, the present programs have not been failures, they have been successes. We doubt very seriously that a nation-wide housing allowance program would be cheaper than the present approaches and it is a delusion to look upon housing allowances as a means of extricating the government from long-term commitments. Once the Federal government commenced providing housing allowances to American families, it would be a political impossibility, as well as a moral one, to abandon abruptly or cut back significantly the program.

As for the costs of the program, I realize that Dr. Henry Aaron of the Brookings Institution, in one of the several papers prepared for the Subcommittee, posited a lower long-term annual cost than that which some estimate the present programs will run. We have serious difficulties with some of Dr. Aaron's calculations and I would like to treat with those a little later in my statement.

We have also looked into the probable costs of a full-scale housing allowance program. This subject was studied for us by the Real Estate Research Corpora-

tion under the supervision of Dr. Anthony Downs, its Senior Vice President. In this major study, performed under contract with us, the National Association of Mutual Savings Banks and the United States Savings and Loan League, and in which the Federal housing subsidy programs were thoroughly analyzed, Dr. Downs comes to the conclusion that a housing allowance program would be more expensive than the present approaches and possibly the cause of many other problems. I would like to offer a copy of that report for insertion in the record.

One of the major problems that a housing allowance program would not seem to be capable of dealing with would be the need to increase the supply of available moderate-priced housing. Another corollary defect would be the possible inflationary impact on prices of existing housing. These and other implications, such as the need for counseling, should, as a minimum, be thoroughly investigated before any major shift. This the Congress provided for in 1970, when it enacted legislation authorizing HUD to conduct an experimental housing allowance program. Unfortunately, HUD has only barely commenced this experiment and it would seem unwise to act before some knowledge has been gained from the experiment.

COMPENDIUM OF PAPERS SUBMITTED TO THE COMMITTEE

I would like now to turn to the compendium of papers submitted to the Joint Economic Committee on the issue of housing subsidies and recently published as Part V of the Committee's review of the Economics of Federal Subsidy Programs. While we do not fully agree with many of the points raised in these papers they have provided to us and, I am sure, to the Subcommittee and to others, a desirable insight to the complexities that confront us in trying to meet the nation's housing needs. We had our staff study these papers at some length and prepare a brief analysis of some of the major points raised in them. That analysis is attached to our statement.

I would like now to touch upon some of the points made in the papers. Dr. Henry Aaron in his paper, entitled "Federal Housing Subsidies", reviews the principal "subsidies" which affect housing. He includes among the so-called subsidies the "special tax benefits for home owners" available for Federal tax payers under the Internal Revenue Code. Deductions allowed for mortgage interest and real estate taxes thus constitute the principal Federal housing subsidy, amounting to somewhere between $6–$10 billion in lost Federal tax revenues annually. He then measures that amount against considerably lesser amounts available under the various direct housing subsidy programs. Naturally, the comparison indicates a vastly disproportionate level of subsidies available to middle and upper income families as opposed to that available to low and moderate income families.

It is difficult to perceive the basis for making this comparison. While the ability to deduct interest and tax payments from one's gross income certainly provides a significant tax benefit for those who have it available, it is an item which has not normally been considered a subsidy as such, and certainly was not included in the Internal Revenue Code with the concept of subsidization in mind. In fact, is the deduction of interest paid on a mortgage loan any more of a subsidy to the home owner, than the deduction of interest on a car loan a subsidy to the car owner?

Since the very beginning of Federal income taxation, interest payments of all kinds have been an item available for deduction from gross income for the purpose of computing Federal income tax liability. Whether this is desirable or not is a question that should be considered in the overall context of tax policy, rather than in the limited context of housing policy. Similarly, the deduction for real estate taxes has been available almost since the inception of the Internal Revenue Code. It is available whether the taxes are paid with respect to one's home, to one's lot at the beach, or to any other real estate owned.

Dr. Aaron also states that the existing system of housing subsidies is inequitable and excessively costly. This conclusion appears to rest heavily upon the premise that the income tax deduction available to home owners is a subsidy and his calculation that lower income families could be housed in socially acceptable housing at approximately $600 a year cheaper under a housing allowance system than under the 235 program. He then proposes institution of a housing allowance program. It is here where the inappropriateness of counting income tax deductions as a subsidy becomes most evident.

Only if you accept the premise that the income tax deductions available to a home owner constitute an overt subsidy, can you arrive at a conclusion that the present system of housing subsidies is more costly. If, instead, you compare only the explicit housing subsidies enacted by Congress for that purpose against the true cost of a housing allowance program, there is no question in our minds that such a program would be more costly. For a detailed analysis of the potential costs of a housing allowance program, I refer you to Dr. Downs' study.

Dr. Aaron estimates that a housing allowance program would cost the Federal government in the range of $5 to $6 billion a year. This estimate is based on the shelter costs reported in the low-cost budget for a family of four estimated by the Bureau of Labor Statistics in the spring of 1967. It is almost 1973. We feel it is totally unacceptable to rely upon an estimate based on such out of date information. Comparing today's costs against the costs of 235 and 236 housing would greatly decrease the alleged $600 gap.

In our attached commentary on the papers we treat with Dr. Aaron's paper in further detail. However, at this point I think it is sufficient to say that we do not believe that it makes an adequate case to throw over presently successful programs for an unknown approach.

We also treat in our commentary with the other five papers. With that of Dr. Henry Schechter we are in essential agreement with the conclusions, including his statement that direct lending by the Treasury probably would be less costly to the government than the present interest subsidy approach. However, as he points out, it would be necessary to restructure the Federal government's budgetary system to establish a capital account for repayable direct housing loans. To date such an approach has not been acceptable to either the Congress or the Administration. It is, however, a prerequisite to serious consideration of direct Federal loans instead of interest subsidies.

The article by Dr. George von Furstenburg points out that there has not been equal distribution of the Federal housing subsidy funds throughout the nation and that in several cases relatively wealthy states have had a higher per capita use than those states with the highest percentage of low income households. There are probably many reasons, such as the nonexistence of public housing authorities in some states and the high incidence of rural, low-income households in others, which had caused this unequal distribution as of September 30, 1969. One serious difficulty, however, is that three years has elapsed since that time, during which the great bulk of the 235 and 236 housing has been provided.

Whether an up-to-date analysis would indicate a more even distribution, we do not know. We believe that it would be important to do such an update before any firm decisions were reached. Furthermore, even if it were to demonstrate a continuation of the indicated disparity, we do not believe that there is a basis for reaching a conclusion that the present programs are ineffectual. Instead, a more appropriate conclusion would seem to be that greater efforts are needed to encourage the use of these programs in those states where the need is not being equally met.

I would like to comment just briefly at this time on the other three papers. With respect to the conclusion reached by de Leeuw and Leaman concerning the Section 23 Leasing Program, we believe it is important that, in conjunction with this paper, the Subcommittee consider a recent report by the General Accounting Office (B–114863) concerning this program which reaches somewhat opposite conclusions. We have found it quite difficult to react to the article on Federal Housing Credit Programs by Drs. Penner and Silber because of the lack of any data substantiating the conclusions reached therein.

With respect to the article by Dr. James E. Wallace on Income Tax Incentives for Rental Housing I would like, at this point, to make just two comments. First, tax benefits available to the owner of Section 236 or 221(d)(3) housing do not substantially differ from those available to the owner of non-subsidized housing. This is important in considering whether there is, in fact, an excessively larger and different subsidy for this type housing.

Secondly, the particular example chosen by Dr. Wallace involving a 236 rehabilitation project is seriously deficient in representing any type of project that exists in the real world. We are unaware of any way the numbers presented there could work in an actual project. We have analyzed this in some detail in our attached commentary and we believe it is important that the members of the Subcommittee look at this analysis in order that they can understand that what Dr. Wallace has set up is, in essence, a straw man.

MORTGAGE CREDIT FLUCTUATIONS

I would like now to move to the third area with which the Subcommittee is concerned, although I find it a little difficult to discuss the subject of mortgage credit fluctuations following such a distinguished witness as Dr. Burns. I don't think anyone disputes the fact that the nation periodically suffers from severe ups and downs in housing production caused by mortgage credit availability factors. The real question is how do we deal with it and achieve a more efficient housing production industry and thereby less costly housing.

Although we have not testified before this Committee before on the subject, we have testified at length on this problem before the Banking Committees of both the House and Senate. As the industry began to feel the crunch of tight money and interest rates in early summer of 1969, we urged the Congress to take quick action on a variety of proposals designed to offset the effects of that crunch. Several of these proposals were ultimately adopted by the Congress, especially in the Emergency Home Finance Act of 1970. Also, we have worked with the Chairman and other members of the Congress to achieve basic changes in the nation's financial structure to prevent these severe fluctuations. Unfortunately, most of the legislative items adopted have dealt more with symptoms than the basic problem.

We were hopeful that, when the President's Commission on Financial Structure and Regulations (the Hunt Commission) was established, it would come up with recommendations which took proper cognizance of the severe inequities worked on housing finance and therefore housing availability, as a result of our present financial structure. Unfortunately, the best assessment we can make of the Hunt Commission report is that it has not progressed beyond the report stage.

While it makes many far-reaching recommendations, it is our belief that, if these recommendations were adopted, housing would be considerably worse off than it is now. Not until the proper priority is given to housing our nation's citizens will we be able to enact the basic changes needed to reasonably insulate housing finance from the effects of the present system of monetary controls. For your information, we have attached a copy of the summary of an analysis of the Hunt Commission report prepared by an NAHB Task Force which conducted an intensive review of the report.

We don't pretend to know all the answers to rectifying the present situation. However, our committees and staff have devoted countless hours to stulying the problem. As a result of these efforts, we have made and supported proposals which we think would at least lead in the proper direction. Included among these are requiring the Federal Reserve System to support housing finance through its open market operations; requiring private pension funds, in return for their favored tax status, to invest a reasonable portion of their vast resources in housing; instituting some type of National Development Bank which would provide funds for housing purposes; and a great many others.

The most frequent opposition stated to these proposals is that they would cause a pinch in some other aspect of the economy. While we don't fully agree with that assessment, we do believe that again the issue of priorities must be faced in the allocation of the nation's resources. Housing finance deserves a high ranking in these priorities.

We have been asked to comment on the recent study by the Federal Reserve staff of housing finance. We believe that this massive work is an important and useful analysis of the situation as it is today. It vividly points out the difficulties caused by wide swings in the availability of mortgage credit and the serious problems experienced by the home building industry as a result of those swings. In this fashion it has served a very important function.

However, after reading through the lengthy summary paper prepared by Lyle E. Gramely, we have had difficulty in ascertaining what firm conclusions the study recommends. Instead, the study points out all sides of the various aspects of the problems, the good points and bad points of various proposals, and leaves one wondering in which direction he should go.

Where the study does seem to point in certain directions, the prinicpal direction seems to be that the only way that this nation is going to assure that housing will be able to obtain its appropriate share of the available credit supply is to remove all ceilings with respect to the cost of money for housing. Such a move could well assure that housing would have available to it the

funds it needs, but we are concerned that the price might be one the American people are both unwilling and unable to pay. The resulting unrestrained high level of interest rates would probably be as severe a disincentive to housing production as that now experienced under more controlled circumstances.

Again, we believe it is important to go back to the issue of priorities. The study by the Federal Reserve staff, while recognizing the importance of housing in the social sense, gives little support to the adoption of policies which would establish a true higher priority for financing housing needs, than that established for other less essential elements of the economy.

We want to congratulate you on holding these hearings. The issues are among the most important on the American scene. Over the years, housing policy in America has largely evolved out of just such searching examinations as you are making. While we have by no means developed any fault-free approaches, there is no question that what we have developed is unique in the world—a method for harnessing the ingenuity and force of private enterprise in cooperation with governmental guidance and objectives.

The housing production record of the 27 postwar years is one of accomplishment and some failures. The successful methods we need to preserve; the deficient ones we need to correct, or do away with. The recommendations that will come out of these hearings I hope will lead us farther along that road.

Thank you for the opportunity to appear here today.

ATTACHMENT A

Selected Date Concerning the 235 and 236 Programs

Included herein are a number of statistics relating to the 235 and 236 interest subsidy programs. These data have been compiled by the National Association of Home Builders from information supplied by the Department of Housing and Urban Development.

These data demonstrate that there have been significant successes under the programs. The very high percentage of families whose subsidies have been decreased upon recertification of their incomes, after two years of residency in homes they have acquired with assistance under Section 235, fully justifies the Congressional belief that this program would encourage families to improve themselves and significantly increase their incomes. This favorable experience on income recertification also demonstrates that the long term costs of these programs will be considerably less than has been projected by many.

These data demonstrate the very substantial production record of housing under these programs for those families who without this assistance would not have been able to obtain decent housing. They also demonstrate that the rate of foreclosures under Sections 235 and 236 is well within the levels contemplated by the Congress when it established these programs.

Income Recertification under Section 235.—In HUD's report on its most recent survey of recertification of income under Section 235 they note, "The salient point of this report is that six out of every ten mortgagors recertifying income and family composition reported decreases in their subsidy payments." The weighted average of this and previous surveys shows that over 60 percent of recipients whose income has been recertified to date have had their subsidies reduced and about 4 percent no long receive any subsidy.

Effect of Recertification on Long-Term Program Costs.—In estimating the long term cost to the Government of the Section 235 Program, HUD has estimated an average annual increase in homeowners' income of 5.7 percent. Based upon the income recertifications to date, homeowners under Section 235 are experiencing a more rapid average increase in income. HUD's estimate of the total cost of funding the 235 and 236 contracts authorized through fiscal year 1973 is expected to be \$4.9 billion for 235 and \$10 billion for 236. Using the experience of the 235 recertifications to date would reduce these projected costs even further. In any case, these projected costs are far below the \$65–\$100 billion figures that have been cited by some sources.

Housing Produced under the Interest Subsidy Programs.—As of August, 1972, cumulative funding reservations for Section 235 amounted to 488,895 units for families of low or moderate income. For the same date, funding reservations under 236 had reached a cumulative figure of 497,029 units. This totals 985,924

and represents an average of about 250,000 units a year in the almost four year life of the programs. This record is even more remarkable in view of the fact that these programs did not become fully operational until well into 1969.

Default Terminations under Section 235.—Under Section 235, default terminations are currently running at a moderate rate of 4% of insurance written. Although this is higher than under the nonsubsidized FHA programs, it is not significantly so, taking into consideration the higher risks contemplated when the Section 235 program was established. It should be noted that "default termination" includes both foreclosures and assignments to HUD. In the case of assignments, which totaled almost 40% of the default terminations in 1971, the mortgagor remains in the home and HUD uses a variety of means to assist him in curing the default.

Default Terminations under Section 236.—As of the end of calendar year 1971, the last date for which final figures are available, default terminations under Section 236 were running about 1.6% of insurance in force. Serious defaults, possibly a more significant measure in the case of multifamily housing, amounted to only 2% of insurance in force.

ATTACHMENT B

NAHB Staff Analysis of the Compendium of Papers on Housing Subsidies

We believe that the compendium of papers submitted to the Joint Economic Committee on Federal housing subsidies contains many valid points and contributes significantly to an increased understanding of Federal policy in this area. However, we also believe that there is room for substantial disagreement with the major conclusions of several of the authors. Before turning to a review of each of these articles, a general cautionary point should be made. A compendium of this sort is not, and is not intended to be, a comprehensive treatment of the subject area and should be considered only in the light of other data and analyses in order to achieve a balanced understanding of matter under discussion—in this case, the activities of the Federal Government in the housing field.

In his article on "Federal Housing Subsidies," Dr. Henry Aaron calculates the amount of Federal housing subsidies under various programs and estimates their distribution according to the income of the beneficiaries. In his analysis, the author treats as subsidies the deduction from Federal income taxation of interest paid on a mortgage, the deduction of property taxes, and the avoidance of taxation on imputed rental income.

Based on this analysis and other considerations, Dr. Aaron identifies three alleged areas of failure in the present subsidy approach: 1) Inequities, on the grounds that "most benefits (taking into account the effects of income tax deductions) accrue to middle and upper income families," and because not all families who qualify on the basis of income are recipients; 2) Cost, because the present approach purportedly costs more than it should; and, 3) Inflexibility, because direct subsidies which are tied to particular units reduce the consumer choice of assisted households. Dr. Aaron recommends as a cure, the substitution of a housing allowance approach for the present subsidy programs.

Central to Dr. Aaron's analysis of the distribution of Federal housing subsidies among various income classes is his view that the income tax deduction allowed to home purchasers is a housing subsidy. In fact, the deduction of interest—a feature of Federal income tax policy since its inception—is permitted regardless of the reason for which the money was borrowed. It is not specifically directed at housing. Presumably, tax payers who do not purchase housing will purchase alternative consumer goods, paying interest to finance their purchases which is equally tax deductible. Likewise, the interest paid to borrow for investment purposes is deductible. Furthermore, while only a small part of most expenditures are taxable as profit to the recipient, interest payments are fully taxed as income to the lender.

Middle income families, who are the chief beneficiaries of the deduction of interest on home mortgages in terms of total dollar amount, are also the people who bear the brunt of taxation by all levels of government under our present tax system. Any changes in tax policy which would have the effect of increasing the liability of this group would seem the farthest thing from the equity which Dr. Aaron favors.

The deduction of local and state property taxes from Federal income tax makes it somewhat easier for those hard-pressed governments to raise needed revenue. It is, in effect, a form of revenue sharing.

The assumed tax savings of homeowners which result from not paying taxes on imputed rental income paid to themselves by themselves may have some validity from the point of view of formal economic analysis, but it bears little relation to the way in which most people think and act concerning their own finances. Furthermore, calculations of imputed rent are no more applicable to housing than to any consumer product which may be leased, rather than bought.

A second area of inequity which Dr. Aaron identifies is that not all of those in the eligible income group receive assistance. While true, at this time, this is not a product of the particular design of the present direct subsidy programs, but a result of a level of funding inadequate to reach all potential beneficiaries. When the level of governmental support is less than the need of the beneficiary group, this inequality will exist regardless of the mechanism used to apply the assistance.

In assessing the cost of the present subsidy programs as too high, Dr. Aaron uses the Bureau of Labor Statistics low-cost budget for spring 1967. He also uses these figures in estimating the cost of a housing allowance system. We believe that these data are entirely inadequate for the purposes to which the author has put them. In the first place, they are out of date. Much more recent data are available from the Bureau of Labor Statistics and elsewhere which would take into account the considerable inflation which has occurred since 1967 in housing and the economy in general. Furthermore, this low-cost budget is one which admittedly allowed for only a very meager standard of living even in terms of 1967 dollars.

Finally, the amount set forth in this budget is not an estimate of the cost of buying a home as Dr. Aaron states, but the cost of renting. This distinction is crucial and devastating to its usefulness in estimating the cost of a housing allowance program. It is undisputed that there is a "gap" of considerable proportions between the number of dwelling units suitable for moderate income families and the number of such families needing dwellings. Therefore, a cost estimate based on the rental of existing units is misleading since, except to a very marginal degree, the additional cost of adding new dwellings to the housing stock cannot be avoided regardless of the nature of the subsidy mechanism.

Of course, this raises the point that the introduction of a substantial amount of additional effective demand for housing by means of a housing allowance without a concomitant increase in supply can only result in a strong impetus toward inflation. Such an inflationary effect would severely reduce or even eliminate the benefits of the program to its recipients and could also have severe adverse consequences for other consumers competing in the housing market.

Dr. Aaron shrugs off this crucial issue of housing supply on the ground that ". . . there is no evidence that linking subsidies to new construction results permanently in a larger housing stock than would exist if housing subsidies alone were provided." There is no evidence to the contrary either. Furthermore, even if an adequate adjustment would take place in the long run under a housing allowance, a cure that is effective in the long run is of little practical benefit if it is fatal in the short run.

In his third and last criticism of the present programs, Dr. Aaron maintains that inflexibility of consumer choice exists as a result of subsidies being available only with respect to particular units. However, Dr. Aaron ignores the other sort of inflexibility which would result from housing allowances which—under present conditions in our metropolitan areas—would tend to restrict subsidized households to areas in which the poor and near poor are already concentrated. In fact, the new construction programs, by building a sizeable number of moderate cost units outside of areas in which poverty is concentrated is contributing to a wider choice of housing—and community—for racial minorities and those of moderate income.

Dr. Henry Schechter's article on the "Federal Housing Subsidy Programs" describes the subsidy programs, their legislative history, operation, and their present and projected budgetary costs. Perhaps the most notable aspect of this article is the well-considered caution with which its author approaches the estimation of the future costs of these programs.

Undoubtedly, a considerable amount of unnecessary alarm could have been avoided if previous authors of such cost projections had noted, as Dr. Schechter

has, that "... (by) looking at maximum and estimated minimum annual subsidy payments under the new and growing (Section 235 and 236) programs, it is obvious that the minimum might be reduced to 50% of the maximum for those programs." In fact, the favorable results of income recertification of beneficiaries of the Section 235 program, which have resulted in subsidy reductions in over 60% of the cases, is one of a number of factors which gives rise to considerable optimism in this regard.

We believe that caution is also the proper attitude towards two of Schechter's other conclusions. While we agree that some savings would probably be realized by using a direct government lending approach in place of interest subsidies, we would, however, stress that a change in Federal accounting practice to recognize the noninflationary characteristics of such direct loans must precede a shift to direct lending. Otherwise, the total cost of each housing unit for which assistance is provided will appear in the budget in the first year. This would mean that for the same first-year budgetary impact, a direct loan program would result in less than one-twentieth of the total number of housing units produced under the interest subsidy approach. Such a result would, of course, doom any hope of meeting the National Housing Goals.

We also tend to agree with Dr. Schechter that the long-term cost to the government under Section 235 (homeownership) is likely to be less than the cost under Section 236 (rental). However, we also believe that, although homeownership is preferred by a majority of people, there will continue to be as a need as well for an adequate supply of rental housing for those of low and moderate income.

The article by Dr. George von Furstenburg entitled, "Distribution of Federally Assisted Rental Housing Services by Regions and States" compares the distribution of Federally assisted rental housing among States with the distribution of low-income families in those States. He finds an apparent lack of correlation among the States between the need for lower income housing and the amount of such housing being produced under the subsidy programs.

The most obvious comment which must be made in connection with this article is that the data used are for 1969. Due to the high production of assisted housing in several of the intervening years, and the continued proportional increase in the number of units under Section 236, it is quite possible that the relationships which he observed have substantially changed. Also, by focusing exclusively on rental housing, Dr. von Furstenburg ignores the extent to which the homeownership assistance program acts to equalize the overall distribution of subsidized housing among regions. For example, while Section 236 housing was relatively scarcer (at least in 1969) in the Southeastern states, these states have been heavy users of the Section 235 program.

In any case, we do not understand the nature of the "marginal net benefits" which von Furstenburg premises would result from a distribution most closely correlated with the number of lower-income families. At the point, still at least several years away, when the production of housing for moderate income families approaches demand and a measurable impact on housing costs in some markets begins to be felt, such considerations might come into play. For the present, however, the effort should be directed toward making use of these programs to achieve the most production on a nationwide basis in the shortest period of time. To deny program funds to an area where housing can be soon produced, in order to reserve funds for another area which is less prepared to use those funds, would be self-defeating.

The Section 23 Leasing program is considered by Dr. Frank de Leeuw and Dr. Sam Leaman. The authors' findings were favorable toward the program based on the opportunity for the location of such housing in existing neighborhoods and anonymity for its residents. They also found the cost of such units to be lower than the full cost of an additional unit of conventional or Turnkey public housing. However, it should be pointed out in connection with this latter point that under the conventional or Turnkey programs, the local public body will eventually own the project, while under the Section 23 Leasing program it will not. This factor should be considered in estimating the relative economy of the various approaches as Dr. Schechter does in his analysis on page 609 of this compendium.

The authors are careful to note that in the communities which they studied, Section 23 units did not absorb a significant amount of the existing housing. We

believe this caveat to be important. While modest use of existing housing may be beneficial, the General Accounting Office has pointed out that:

> The acquisition of non-subsidized standard housing by LHA's in areas where demands for both non-subsidized and subsidized housing exist merely increases the quantity of subsidized standard housing at the expense of non-subsidized standard housing and does not improve the overall condition of the housing market. It appears that in such cases, the construction of new housing and the rehabilitation of substandard housing would be the preferred methods of meeting the demand for standard housing.[1]

The article by Dr. Rudolph Penner and Dr. William Silber is entitled, "Federal Housing Credit Programs: Costs, Benefits, and Interactions." However, since the costs of which they speak are not quantified (and often cannot be quantified, according to the authors) it is virtually impossible to assess the importance of the interactions which they discuss. Therefore, at the most, this article indicates some areas in which further investigation might prove useful.

One point, however, deserves mention. The authors state on page 664 that housing starts under Sections 235 and 236 totalled 116,000 units in 1970, but that it does not follow that these units represent a net gain in total production since very nearly the same number of unsubsidized units would have been produced in the absence of these programs. In fact, starts under Section 235 alone were 116,000. An additional 105,000 units were started under Section 236.

More importantly, during the 1969–1970 period the supply of mortgage money from the four financial intermediaries (S & L's, Mutual Savings Banks, Life Insurance Companies, and Commercial Banks) declined so markedly that there was virtually no money available for conventional financing. Permanent mortgage interest rates for the scarce funds which were available hit a 100-year peak of well over 8%, construction financing was nearly 10%, and there was a nearly total freeze on commitments. Under these conditions, we believe that it is inconceivable that more than a tiny fraction of the 221,000 units built under Sections 235 and 236 would have been built without them.

The article on "Federal Income Tax Incentives in Low and Moderate Income Housing" by Dr. James Wallace focuses on the accelerated depreciation available under the Internal Revenue Code to investors in newly constructed and rehabilitated rental projects under Section 236. Wallace is critical of accelerated depreciation as a means of encouraging investment in low and moderate income rental on several grounds. His chief objections stem from his belief that the relatively passive investors in such projects have an insufficient motive to maintain adequate management services and, more generally, that because the benefit to investors occurs mainly under the tax laws while the responsibility for overseeing management rests with HUD, the latter is less able to properly perform that function.

Although Dr. Wallace appears not to charge that the tax advantages to investors are excessive, he includes hypothetical examples of Section 236 projects which are likely to lead others to that conclusion. Wallace places particular emphasis on the allegedly high return to developers, investors, and others under the Section 236 Rehabilitation program. Since the rehabilitation portion of the Section 236 program has amounted to only about 20,000 out of a total of more than 400,000 units under Section 236, we believe this emphasis is misplaced. Furthermore, if the Section 236 Rehabilitation program was as attractive as the author assumes, we wonder why it has not attracted more active participation on the part of developers and investors.

Wallace's recommended alternative to the present system is to pay builder/developers an adequate fee at the outset and to make direct operating subsidy payments to encourage good management. He particularly favors the management of projects under such a system by tenant cooperatives and other non-profit organizations.

We do not believe that the record to date supports Dr. Wallace's supposition that HUD's inability to change the tax benefits to investors (short of foreclosure) renders it less capable of requiring good management. By contract, under the Regulatory Agreement that is part of every transaction under HUD's multifamily programs, HUD has the right to direct management policy or even to take over the management itself. Since the limited dividend of up to 6% for

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[1] The General Accounting Office, Benefits Could Be Realized by Revising Policies and Practices for Acquiring Existing Structures for Low-Rent Public Housing (B-114863).

profit-oriented sponsors is available only after the costs of operation and reserves are met, there exists on this basis alone a substantial incentive toward effective management and compliance with HUD directives.

Even more importantly, in the typical Section 236 situation, at least one partner, usually the developer, remains personally liable under the State laws controlling business organizations. Furthermore, inadequate performance on his part not only raises the risk of catastrophic financial losses with respect to the particular project, but also will result in his debarment from further participation in HUD programs. Of course, the developer must also keep in mind the effect of his previous performance on his ability to attract investors for future projects. In short, under the usual limited dividend sponsorship arrangement there exists both a strong motivation toward good management by the sponsors and a more than adequate opportunity to require good management by HUD.

We do not believe that a general preference for cooperative or nonprofit sponsorship over profit-oriented sponsorship is warranted. For example, while cooperatives are appropriate in some circumstances, the additional responsibilities, and the dependence on the financial capabilities of other occupants, will not appeal to everyone, particularly in the case of projects designed primarily for those of modest income.

Too often non-profit sponsors lack the knowledge of management necessary to effectuate their good intentions. Furthermore, the simple fact is that the members of a non-profit sponsor stand to suffer less personal loss as the result of a project's failure than does a profit-oriented sponsor. According to HUD, non-profit sponsors are suffering a foreclosure rate many times in excess of that of other sponsors under the Section 236 program. This seems to indicate that substantial economic motivation, together with proven ability, is a more adequate basis for housing management than simple eleemosynary purpose.

Dr. Wallace's article is likely to cause some readers to reach the erroneous conclusion that the developers, brokers, and investors in the typical Section 236 project enjoy windfall profits. In fact as Wallace himself states in a footnote on page 688, the depreciation allowances for a Section 236 project are exactly the same as for other new residential construction. A difference exists only with respect to recapture provisions. As to the modest effect on the rate of return which results from this difference in recapture treatment, we recommend reference to the calculations of Dr. Schechter on page 615 of this compendium which estimate that the potential annual rate of return under the tax laws for a Section 236 project exceeds that for a non-subsidized rental project by only four-tenths of one percent of investment. This is a rather modest additional return considering the somewhat higher risks inherent in an investment in housing for those of lower income and the likelihood of a considerably smaller cash flow.

In describing the Section 236 Rehabilitation program and its related tax advantages, Wallace uses a hypothetical case which we believe to be extremely misleading. According to Wallace, the builder/developer in the case of a rehabilitation project with a replacement cost of $2,222,222 and an FHA mortgage of $2,000,000 will receive $400,000 on an investment of $60,000, the broker who "packages" the project for investors will receive $100,000, and the investors will receive $200,000 per year in tax savings for five years on an investment of $500,000. The investors may also receive some part of the maximum 6% limited-dividend return from rental proceeds.

However, this hypothetical case contains several errors of fact and neglects several other important points which taken together demonstrate that the apparent windfall profits from such a transaction are illusory. If a Section 236 Rehabilitation project is built by a limited dividend sponsor with a replacement cost of $2,222,222, it will qualify for a maximum FHA mortgage of $2,000,000. This leaves $222,222 in equity money which must be paid by someone. Presumably, Wallace assumes that this money is made up of a combination of the $60,000 out of the pocket of the developer and the developer's contribution of the Builder and Sponsors Profit and Risk Allowance (BSPRA) to which he is entitled.

Developers of these projects do frequently leave the BSPRA in projects of this sort, but to give consideration to the developer's $60,000 cash investment while treating the much larger contribution of the BSPRA as somehow non-existent is misleading in the extreme. The developer's role in these projects is not a passive one and the BSPRA is his lawful recompense for the time, skill, cash, and risk which he has borne in achieving the rehabilitation of the project.

Therefore, his contribution of the BSPRA is as much an investment as the additional $60,000 in cash.

In a further slight of the contribution of the developer, Wallace assigns no value to the land or in the case of a rehabilitation project, the land and existing structure, which the developer provides. The value of the land in a typical Section 236 project is about 5% of the total project cost.

The payment which the builder can expect from investors for a sound Section 236 Rehabilitation project is currently 13% of the mortgage amount in the eastern United States; not the 25% premised by Wallace.

The investors in such projects are currently paying about 18% of the mortgage amount. The difference of 5% of the mortgage amount is the broker's fee for undertaking the responsibilities for the legal. financial, and other aspects of offering the project and for advising the investors as to the soundness of particular offerings.

Eighteen percent of the mortgage amount equals $360,000 ($2,000,0000 mortgage x 18%) and this would be the total amount paid by the investor for the project; not $500,000 as Wallace assumes. This entitles them to depreciate the rehabilitation cost of the project over five years on a straight-line basis. But they may depreciate only the rehabilitation costs and the maximum recognizable amount of rehabilitation costs is limited by the Internal Revenue Code to $15,000 per unit. That part of the project cost which represents the pre-existing structure may be depreciated at the rate otherwise applicable[2] and land is not depreciable at all. Therefore, since Wallace supposes that the project in our example is composed of 100 units (see chart, page 684) the maximum amount available for the application of the five year write-off is $1,500,000 ($15,000 x 100 units). This would provide a maximum of $150,000 per year in tax savings for an investor in the 50% tax bracket ($1,500,000 divided by 5 x 50%): not the $200,000 according to Wallace.

This is still a handsome return on a $360,000 investment for those who can make full use of the tax shelter opportunities, but to consider only the first five years of the existence of these projects badly misinterprets the position of the investor. This is because these tax savings are subject to complete recapture during the first 100 months of the project and recapture on a declining scale for an additional 100 months thereafter. In other words, to retain all of the tax advantages, the investor must hold the property at least 16.8 years. Dr. Wallace, in fact, premises that the investors will hold the project for 20 years. Using a holding period of 20 years the undiscounted annual return to the investors is about 9.5% ($360,000 investment divided by $150,000 return × 5 years divided by 20 years) exclusive of cash flow, if any. Even if a heavy discount factor is included to take into account the advantage to the investors of receiving their return in the early years, it is obvious that the nature of these transactions cannot be understood by looking only at the return in the first five years.

It must also be pointed out that the twenty-year holding period for an investor in a Section 236 Rehabilitation project is not without risk. A sale of the project during the first ten to twelve years will trigger recapture with potentially disastrous consequences to the investor. Of course, the investors are not likely to voluntarily sell the project, but a foreclosure is treated as a sale for tax purposes. By the very nature and purpose of Section 236 Rehabilitation projects, that of serving lower income tenants in older sections of the city, they have a relatively high risk of foreclosure. Balancing the risks implicit in these facts against the benefits to investors, many of the more knowledgeable investment advisors doubt that they are in any way superior to other, safer real estate investments even for those who can make full use of the tax shelter opportunities.

Two final points should be mentioned. It is generally conceded even by the critics of the Section 236 program that the annual interest subsidy costs to the government are unlikely to extend for the full term of the mortgage. Therefore, Wallace's statement on page 685 that the interest subsidy in his example will equal $100,000 per year for 40 years greatly overstates these costs.

Finally, the payment of a direct development fee as a substitution for the profit from syndication will, if included in the mortgage, raise the fair market rental of the project. Wallace would compensate for this by increasing the annual government subsidy. Even if this were done, however, the additional developer's fee in the mortgage would make the unsubsidized rents for a Section 236 project

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[2] 125% of straight-line depreciation if the useful life of the project is 25 years or more; straight-line depreciation only if the useful life is less.

less competitive with conventionally built projects and would reduce the likelihood of achieving an income mix in projects under the program.

ATTACHMENT C

Highlights of NAHB's Financial and Economic Studies Task Force Review of the Report of the President's Commission on Financial Structure and Regulation

NAHB's Financial and Economic Studies Task Force thoroughly reviewed the recommendations of the President's Commission on Financial Structure and Regulation (Hunt Commission). The Task Force commented specifically on each recommendation of direct concern to the housing industry and transmitted its conclusions to NAHB's Executive Committee. The following are the highlights of the report as adopted by the Executive Committee:

The recommendations of the Hunt Commission, if enacted in toto, would be extremely detrimental to the residential mortgage market. The Commission advocates movement away from specialization and toward greater homogenization of financial institutions. This can only hurt the housing industry, for with more diversified investment opportunities, institutions would assign an even lower priority to investment in housing than they do at present. Furthermore, it has been our experience that only the specialized institutions have supported the housing market to a degree necessary to make significant progress in achieving our national housing goals.

We concur with the "additional views" of Commission member Morgan G. Earnest. He outlined areas in which the Commission "failed to come to grips with the overriding problems of providing a more stable flow of finances into the residential mortgage market."

In addition, we are concerned with the Commission's omission of consideration of the social responsibilities of life insurance companies and, particularly, pension funds. Both have special privileges and thus, should have concomitant special obligations.

Life insurance companies receive a substantial amount of people's savings. Certainly they should invest some portion of these funds in housing for the American people. Instead, they have decreased their investment in single family residences to the point of negative mortgage flows.

Private and Governmental Pension funds, the fastest growing pool of savings in this country, enjoy special tax concessions. Yet they are under no social obligation with respect to the deployment of their funds, and they have actually decreased the portion of their asserts invested in mortgages over the past few years. They have done so despite the efforts of government and private sources to develop mortgage-related instruments of investment grade and yields.

Instead of offering innovations in the field of housing and real estate finance, the Hunt Commission recommends and advocates a laundry list of long-standing proposals sponsored by financial institutions. The Commission's recommendation that the Federal Government provide direct subsides to consumers in the event that mortgage financing is not adequate to achieve national housing goals is an inadequate, unrealistic substitute for innovative ideas and an abdication of the Commission's responsibility to come to grips with the real problems of mortgage financing.

In summary, NAHB's position on the Hunt Commission Report may be outlined as follows:

(1) Opposition to:
- (a) abolishment of interest ceilings on time and savings deposits
- (b) abolishment of FHA/VA interest rate ceilings
- (c) increased investment powers for thrift institutions
- (d) homogenization of financial institutions
- (e) imposition of heavier tax and regulatory burdens for thrift institutions
- (f) insurance programs against interest rate risk to mitigate the problems faced by mortgage lenders
- (g) sole reliance on the Federal Government's direct subsidies to consumers in the event that mortgage financing is not adequate

(2) Support for liberalized chartering and branching powers for *all* institutions, and

(3) Criticism of the Commission's ignoring the social responsibiilties of life insurance companies and pension funds.

Chairman PROXMIRE. Thank you very much. Mr. Waranch.

Let us assume you are the President of the United States, instead of the president of the home builders for a minute, and you are faced with a growing budget deficit and a series of scandals in our housing program. The Secretary of Housing has just resigned, and you want to scuttle the whole program. Who would you appoint as your new Secretary? Would you appoint a recognized housing expert, a man with housing experience, a man with a regard for the environment to work for housing, or would you appoint a man who has no housing experience, perhaps a corporation lawyer, and who has no association with mayors or Governors and others who have been concerned with homebuilding, a man who has been identified as very sympathetic and subject to White House control?

Representative CONABLE. Is this a hypothetical question?

Mr. WARANCH. I want to first tell you, Senator, that the pay being President of the United States is a little better than what I have received in the past 11 months as being president of the home builders.

Certainly, if I had the decision to make, and being very heavily housing-oriented as I am, perhaps I would look for the best man for housing, but as I look at the Department of Housing and Urban Development, I guess that I would have to be quite broad in the interpretation of everything that Department is supposed to do. I do not know that I would necessarily limit my choice to a man who holds only expertise in housing. And I certainly do not want—I am sure the Senator does not want my remarks in any way to touch upon the ability of the President's choice for the role of Secretary. And I hope that I will have the opportunity of meeting with him, and to find out what his expectations are.

Chairman PROXMIRE. I asked this question very seriously because another committee that I happen to serve on has the responsibility for acting on the confirmation and I wanted to take this opportunity to get some advice from you. This is a man of real intelligence and extraordinary administrative ability, apparently, from all reports. He had a very fine capsule biography written about him in the New York Times, but he is a man who has, as I say, just nothing, no association in the housing field in which you are deeply concerned or with the other responsibilities of HUD. And that may or may not be a good idea, but I would like to get your view as one who has such a deep concern, and represents an industry in which the Federal housing policy is so vitally important.

Mr. WARANCH. Senator, you know of my concern for the disruptive situation that has existed in HUD. Certainly it is no secret that we have been very much concerned with the constant reorganization. We think that part of the problem has been the need for a strong administrator, and perhaps that may be where the designee of the President will fill that role, and provide for assistants and undersecretaries who are experts in the field of housing. We hope that if he will listen to them, as a good administrator should do, that this will make our job of providing housing a more simple one as far as the bureaucratic problems that we have had are concerned.

Chairman PROXMIRE. I understand your position. You do not want to get off on the worst possible foot with the new Secretary. You want

to get off on the basis of cooperating and I think that is commendable. In view of your interest and responsibility, I think you have answered that question about as well as you could.

Let me ask you something else. You have had a chance to hear the very able and distinguished Chairman of the Federal Reserve Board, Mr. Burns, for whom all of us have great admiration as an economist. I disagree with him sometimes, as I disagreed with him on some of the policies we discussed. I was struck by your evaluation of the Federal housing study. You say it is hard to tell in which direction they are going. You say:

> The principal direction seems to be that the only way that this nation is going to assure that housing will be able to obtain its appropriate share of the available credit supply is to remove all ceilings with respect to the cost of money for housing. Such a move could well assure that housing would have available to it the funds it needs.

And then you go on to say,

> But we are concerned that the price might be one that the American people are both unwilling and unable to pay. The resulting unrestrained high level of interest rates would probably be as severe a disincentive to housing production as that now experienced under more controlled circumstances.

In other words, you believe that the Federal proposal to end interest rate ceilings will so raise interest rates that it will restrict housing production and add to inflation. What do you propose as techniques to moderate instability in the mortgage credit area?

Mr. WARANCH. Well, we certainly do not think that lifting controls, particularly regulation Q, among others, is the immediate answer. We have very serious concerns that, whereas the fight against inflation has been certainly helped by phase I and phase II, we see very serious concerns in the overall application of the inflation picture. For example, we have been seriously struck by the fact that you mentioned that banks, Senator, are making profits that are not necessarily in line with any guidelines of other corporations—profit limitations which other corporations are saddled with. We see a very serious problem with respect to the price of lumber, for example. I have commented that the price of a $25,000 house built today includes $900 more for lumber than went into that house just a little over a year and a half ago.

Chairman PROXMIRE. Could I just interrupt to say that what I am primarily trying to get at is what your position on the kind of action that could be taken by the Federal Reserve Board or by other agencies with respect to providing more credit?

Mr. WARANCH. May I let Mr. Rogg comment on that?

Chairman PROXMIRE. Yes. Fine.

Mr. ROGG. One of the things that troubles me about the Federal Reserve studies and also the massive summary of the studies, was the fact that they seemed to have been based, in part, upon an assumption about the flow of funds during the rest of this decade with which I have some serious questions. A study by Mr. Taylor of the Federal Reserve Board, also made available to the Hunt Commission, suggested that the problem during the decade would not be the flow of funds into mortgages. There would be an adequate supply but there would not be an adequate supply for business purposes and for

business expansion. I find a great deal of difficulty in agreeing with that particular set of conclusions.

Now, there are many things that need to be done if we are going to get stability into the housing scene, and I do not mean the kind of stability that high interest rates would imply. If you remove all of the controls you are going to get interest rates at levels that will provide funds that the American people cannot use. It seems to be abroad in many circles today that housing is going to be down next year because the demand is going to be down. Now, I tend to think that treats demand as something under glass and it pays no attention to the probable impact of lesser funds flowing into housing.

You know, most of the increase in housing starts, and the last 2 years have been in best in that regard, has been in the area of subsidized housing. You decrease those funds, and you have cut the demand by taking away the economic muscle.

Chairman Proxmire. There is some indication they may be decreased. But, what would be your recommendation with respect to credit?

Mr. Rogg. Well, on the credit thing, I think that the Federal Reserve can do certain things in terms of fluctuating reserves. I think that you could do some things by dealing with the issue of what pension fund involvement in the mortgage market is. This is the fastest growing new source of funds in our society and it is not going into housing. You have less than 4 or 5 percent in this area. I think that we must maintain regulation Q in this period ahead, because I think if you do not you are going to put the thrift institutions in a disadvantageous position in competing for the supply of capital. And I think, too, I would agree with the notion that we need to get a better fiscal position and better fiscal policy in the country. And one which pays some attention to balancing the needs of the country out in a more stable manner.

Chairman Proxmire. I am hitting you gentlemen all of a sudden with this, and you may not be prepared to answer this and perhaps you would like to answer it for the record. But, I did make a proposal that the Federal Reserve be empowered to restrict borrowing by large corporations, not to eliminate it, of course, but to cut it down to a percentage of a base period.

Mr. Rogg. We do not have a policy on that but my own personal feeling is that something in the form of a capital credit resource commission would be a useful device. In short——

Chairman Proxmire. You think that would be another way, so you could do it with respect to equity as well as with respect to size?

Mr. Rogg. Yes, sir.

Chairman Proxmire. All right. Fine.

Let me ask you. Although you indicate, Mr. Waranch, that there has been some improvement in the last few months, your comments on HUD add up to a devastating indictment of their last 4 years. You say that (1) there have been inadequate inspection appraisal by FHA personnel that resulted in lower income families buying homes at exorbitant prices; (2) HUD officers have failed to carry out their own prescribed procedures; (3) years of continuous reorganization resulted in chaos in the HUD Administration; (4) morale is low; and (5) in

some places FHA completely stopped processing until builders just gave up and quit. In other places, they speeded up processing so that there was no time for proper review and property inspection.

Is there anything you would like to add to that, anything in anyway that you would like to refine or document?

Mr. WARANCH. Well, I think certainly to say it is an indictment would be rather strong. In this society——

Chairman PROXMIRE. I would say that puts it mildly. If that is not an indictment, I have never seen one.

Mr. WARANCH (continuing). I would say unfortunately most of us recognize that indictment does not mean guilty. I say that these are facts that we have called to the attention of the secretary of HUD. We met with him, I believe, on June 1, when things were really at their worst. The newspapers had been clamoring about the programs, unfairly perhaps, because they were not being accurate in other reporting and lumping all of the HUD programs and calling them one thing when they were actually something else.

The Secretary indicated to us that he, in recognizing the President's desire to cut spending, had reduced his personnel and that it was not until the "cat was out of the bag" so to speak that he realized some of the problems that were occurring in these programs. Now, the programs that were causing the big problems, by and large, you mentioned Detroit as an example, were not subsidized housing programs. As you know, Senator, most of the houses that were causing the big troubles in Detroit were under the 223(e) program. This program was put up into effect in the so-called red-line areas, and then recognized that there was a risk involved.

The one thing that the Congress did not expect and, perhaps, should not have expected, was that there would be abuses in the program. The program works well when it is properly administered, but you cannot go into an area and make an inspection from the outside, and not go into the unit and see the condition of the unit inside and out. There were indications that that is what happened in some of those areas if, in fact, the units were even looked at, at all.

The administration of the program is where the problems have taken place. I have been in this business just about 24 years. In fact, 24 years and 6 days. I started on December 1, 1948, and the only business we did in those days, primarily, was FHA. Later we moved. It was FHA and VA but, right now, we are not doing any business at all, if possible under the Government programs because of the redtape, because of the fact that they reacted so violently to the problems that took place.

Now, it also means that I am not building housing personally to take care of the people who cannot afford to pay substantial downpayments, 10 percent or more. Also, the fact that the programs are so slow to react. The mortage ceiling on a FHA loan of $33,000 is (in today's inflation, so far out of the window, that you cannot even deal with that sort of thing. So, true, there is an indictment perhaps in my saying that these things are taking place over at HUD.

There were improvements once the Secretary jumped in with both feet, and once he was able to go to the White House and get the Office of Management and Budget, because of a directive from the President, to let him hire some people he needs. But, you just do not hire these

people overnight. So, I look to the fact that FHA is in a very tenuous position in HUD right now. It is neither fish nor fowl but, certainly, with proper administration of these programs FHA can be the viable force in providing housing in this country that it has been in the past.

Chairman PROXMIRE. Congressman Conable.

Representative CONABLE. Thank you, Mr. Chairman.

I would like to ask you, sir, to spell out a little more of your problems in the lumber area. First of all, is this a greater concern in terms of meeting this Nation's housing right now than the cost of money? Second, are you getting some cooperation from the Price Board in trying to get lumber prices under control? Third, is there much difference between the market situation on lumber and the market situation with respect to food? As I understand it, they are trying to control lumber prices by controlling margins on the retail level instead of trying to control raw prices at the source, for fear of shutting off supply.

Do you have any hope of getting a handle on lumber prices in the foreseeable future? I know this is a major concern of yours and I would like to get your answer on these various questions.

Mr. WARANCH. Well, I hope that I recall all of the questions and I will start in reverse order if I may.

First of all, as far as the handle is concerned, I am a born optimist, so I certainly hope that we will have a handle. Senator Proxmire may well remember in 1969 when one of my predecessors in office appeared before the committee and talked about lumber prices. You will remember, Senator, I am sure, that the most graphic illustration that he was able to present to this committee was the fact that he said that 1 year ago this is how much money a piece of plywood would cost, and he held up the money and he held up a piece of plywood and he put it on the easel and he said today this same amount of money will buy this much plywood, and he put up a little small piece. I think you remember that.

Chairman PROXMIRE. Very vividly.

Mr. WARANCH. Then he held up some 2x4's and how much 2x4 you got for the same amount of money and it was a little stub. That is child's play to what is happening today.

I have been a year in office, and I only have about 38 more days, but when I go out of office, unlike the President of the United States, I cannot succeed myself. The one thing that has caused me more concern than any other problem that has been a problem for the housing industry this year, including all of the scandals with respect to HUD, and all of the other problems, has been this lumber problem, because it is affecting everybody. The problem is that the consumer himself does not realize just what it is costing him, because it has got to cost him in terms of buying the house, or in terms of rent payments, if he is going to live in property that was built with this high-priced lumber.

We have met with the Price Commission. I personally have met with Mr. Rumsfeld, and they have taken some steps. As you know, from time to time the wheels of Government move quite slowly and I perhaps am not satisfied that they have moved fast enough. At this stage, they have asked the Internal Revenue to look into some of the

profit problems. They asked the Justice Department and the Federal Trade Commission to look into some of the antitrust charges. But, looking is not bringing the prices down.

Prices have come down in the last few days slightly, but those prices coming down, we understand, are due to the fact that in some areas of the country building has slowed up a little bit and that is making lumber and lumber products available in other areas of the country at a little lesser cost.

But, the real problem is really just being rubbed over, glossed over; nobody has really gotten down to the nuts and bolts of what it is going to take to bring the price of lumber down.

One of the things certainly that the Congress is going to have to look into is making money available to produce more trees. The planting programs have been seriously neglected and, according to a report that I heard, in three decades there will be absolutely a complete shortage of lumber if we do not start planting now to take care of what will happen 30 years from now.

I believe that we have to be concerned about the ecology and I want to make it clear that the National Association of Home Builders is not advocating raping the forests. We advocate a sensible plan of clear-cutting, a sensible plan of refurbishing and selective cutting and a definite plan of putting in more trees. A tree does not grow overnight.

Getting back to your other question, whether or not there is something that can be done, I think that it is going to take a concerted effort on the part of the Executive and the Congress, to do something to bring the lumber people in, to find out why the prices cannot be kept under control. My concern is that if you look at the profits some of the major producers of lumber who are public companies, their profits get published in their annual statements—I do not have the exact figures before me, and I did not know you were going to ask the question or I would have had them available for me, but certainly the New York Stock Exchange can make them available without any trouble because they have them—and these people are making higher profits. You mentioned the banks, Senator, and they are child's play compared to some of the profits that are made by some of the large lumber producers.

In addition to that, I think you have also to realize one of the problems with the profit limitations is that smaller mills are making their profits that they can make and they will say, why, we cannot make any more profit and if we do we are going to come under attack by the Internal Revenue Service. So, they are closing their plants and this is creating shortages.

We have made several recommendations to the Price Commission and we have been joined by the National Association of Retail Lumber Dealers and Builder Suppliers who are also vitally interested in this problem. If we do get some help, all across the board, we think there will be a substantial reduction in the price of lumber.

Representative Conable. Well, it appears that you are saying there still is not a very serious supply problem, for whatever reason and that it is, therefore, not just an administered price, although there may be some elements of that in the supply problem. The problem goes more deeply than just the holding of lumber from the market.

Mr. WARANCH. I think that that certainly does go more deeply. But, I think, I have been accused of using words like shananigans, and innovative methods of distribution and I plead guilty. I have used all of those in describing what is being done. They have come out with so-called new products and have stopped making other products that they consider to be less profitable. And the new products are nothing more than a sham. So, there is no question that it is all these things. Perhaps these people have staffs of lawyers and I am sure that they are living by the letter of the law but certainly not the spirit. I think that there is a public concern that the price of housing, even more importantly than the cost of money, is the cost of the essential ingredients that go into the house.

Representative CONABLE. Isn't the problem of controls in the lumber industry quite analogous to the problem of controls with respect to food? Is not there a pretty close parallel there because of the probability that control at the source will simply result in the withholding of materials?

Mr. WARANCH. I really am not going to say that I am qualified to comment on the controls with respect to food. But, I think that there is a parallel certainly, after all, with the exception of one or two major producers, most of the lumber in this country is controlled by the U.S. Government.

Representative CONABLE. And is the harvesting of Government timber more closely related to Government policy than it is to the availability of those who can contract with the Government about such things?

Mr. WARANCH. Yes. I think also there is another fact and, that is, that the Forest Service tells us that there is more and more lumber that could be made available if they could get money to provide access into the forest to get the lumber out.

Representative CONABLE. Isn't the contract price on Government timber related to the level of timber prices also, so it is considerably more profitable for a company to harvest its own timber than it is to go in and cut on Government land?

Mr. WARANCH. The lumber people tell us the price is set by the market and it is a bidding sort of situation, a matter that we really cannot do too much about.

Representative CONABLE. It sounds complicated but, apparently, this is one of not only one of our major concerns but it is one of the major concerns in the housing industry right now, and even more of a problem than the availability of money. Of course, the availability of money is not something that you can entirely ignore either.

Mr. WARANCH. I think we ought to point out a couple of things. No. 1, there is no fully effective control of prices at the retail level on lumber. No. 2, the incredible thing is that here we are sending millions of board feet of lumber out of this country every year when there is such a crying need for lumber at home and that is the thing that our members cannot understand. They see that here you are exporting lumber, timber, and we here in this country have such a need. If there is such a shortage than what are we doing sending it away? It is a very difficult question to answer.

Representative CONABLE. The Japanese must be willing to pay more for our timber than we are. Is that right?

Mr. WARANCH. Yes. But, suppose the shipper of the timber is subject to controls. If he has a gross volume of more than $1 million a year and again I have said that there there seems to be a flagrant abuse. I might add that Mr. Carpenter of the Price Commission in making a statement recently to the press confirmed that in all of the investigations that they have conducted so far, that there seems to be flagrant abuse. Thirty percent was the figure he used, which is, I think, an unconscionable number of firms who should know better.

Representative CONABLE. I do not understand what you are saying about the 30 percent.

Mr. WARANCH. 30 percent of the firms investigated by the Internal Revenue Service and there was a large number, I think there were 2,000 firms, I am not sure of the exact number, and 30 percent of them violated the price regulations.

Representative CONABLE. Margin?

Mr. WARANCH. No.

Representative CONABLE. Margin of profit?

Mr. WARANCH. Not necessarily on margin, on profit limitations and other violations in their pricing policies.

Representative CONABLE. Thank you.

Chairman PROXMIRE. Well, you get to the point where there are two alternatives. You have mentioned one at the very end and, that is, the export of lumber. This is something we were concerned with a couple of years ago when we got into this area, and the same terrific problems where they are putting people in a position, these exporters, an impossible position where they have to lay people off and there is tremendous inflation in their operation. It is very, very difficult.

It seems to me that one thing you might consider, we might consider in this area, is rationing, you know, you would not like it but that is one thing you do when you have genuine shortages. You ration what you have available. That is one way of bringing the price down.

Mr. WARANCH. I think that a more appropriate way——

Chairman PROXMIRE. One of the few areas where we have a shortage of materials—in the long run where we have reforestation and that takes years—how long does it take for a newly planted tree to grow; 25 years?

Mr. WARANCH. That is why the Forest Service says they should be planting trees today because the lumber people tell us there is an adequate supply of trees to harvest in this country right now; that there is no problem with trees and I am not speaking without regard to the ecological effect. We are not talking of raping the forests. Some ecological advocates do not realize that certain trees, unless they are cut, go to rot and if they are not cut at the proper time, the longer they stay there, there is less productivity from that tree than you could get. You do not get full use of the lumber.

Chairman PROXMIRE. All of this is true but what I am saying is it would seem to me in the longrun we need to take a look at the adequacy of the reforestation program and research program because lumber is not the only material for constructing homes. But, these things take time. Meanwhile, we have a short-term problem, which although there undoubtedly have been violations on the part of the lumber firms and you document that very well, and a 30-percent price increase is

shocking, we need better enforcement, and in spite of all that it seems to me we ought to consider something that you would have to consider. We had it in World War II. When you have a genuine shortage of a resource the fair way to do it is to provide for at least for consideration of a rationing. That means you limit the amount of production you have got, but it also means you limit, of course, the inflationary effect and it does not just go through the ceiling as it has done in this case.

Mr. WARANCH. I think the more important thing would be to put an item by item ceiling on prices, which would bring the price down, and perhaps by export controls—remember in 1969 I think Japan who was our principal buyer, voluntarily agreed to a reduction. I use the word "voluntarily" but that is what it amounted to. And perhaps if we could get some of this "voluntarily action" now there would be enough material available. And part of our problem is the fact they said they slowed up a little bit and housing went down, and they closed some plants and closed some production. Well——

Chairman PROXMIRE. Let me suggest that this is a fascinating area. You might want to, when you correct your remarks, expand this in any way you wish.

Let me get into something else. The GAO found that about 24 percent of the new homes under 235 ownership had significant defects, and defects were 50 percent, significant defects, under the 502 home ownership programs. Why are there so many defects, and such poor quality construction? What specific action does your association take to correct the situation?

Mr. WARANCH. First thing is we tried to find out what exactly the defects were. Are they talking about a screw missing or are they talking about substantial construction defects. As of this date, we have yet to get an answer from HUD as to what the audit actually revealed. We have not gotten copies of the audit.

Chairman PROXMIRE. We will be delighted to give you the kind of examples they gave us. They gave us pictures which showed holes in the roof, conspicuously bad wiring. They documented this in considerable detail. Have you had a chance to see their overall report? We will be happy to make that available to you, because I think that is a very serious indictment of some of the people in your industry.

Mr. WARANCH. Mr. Coan would like to comment.

Chairman PROXMIRE. Fine.

Mr. COAN. Senator, I understand that the GAO report has not yet been released.

Chairman PROXMIRE. The overall full report will be coming in later but we can give you the report we got, plus the pictures.

Mr. COAN. Fine. HUD ran an internal audit of the 235 program, and their own internal audit came out with the figure of approximately 24 percent. Our only trouble was we wrote the Department and asked them to detail what the exact items were in order to try to make some objective judgment of it. We wrote to the Secretary in September or May, rather, and we still have yet to get that type of data. We did get a response to the letter, of course, but there is no such information available. What little was set out in their internal audit, when we ran it through out technical people, they had trouble

following the terminology, because the terminology used did not even fit into that technical terminology which is usually used in connection with the construction of homes.

Chairman PROXMIRE. You gentlemen are not telling me, however, that there are not problems, very serious problems? We had one of your members, Mr. Emmer, who testified the day before yesterday and who admitted there were very, very serious problems, that some of this workmanship is very low quality and there are serious defects.

Mr. WARANCH. Well, I certainly will say to you, Senator, that there are, I am sure, builders who do not build as well as other builders. I know that in Chicago, for example, that there were some problems there in new construction.

Chairman PROXMIRE. What can your association do about this?

Mr. WARANCH. In that particular case?

Chairman PROXMIRE. Well, in general, in that particular case and other cases?

Mr. WARANCH. Well, first of all, I have this year appointed a consumer advisory committee. The committee has been expanded to include four people from the general public, and they will be meeting with our people on this coming Tuesday, December 12, and we have been working very closely with Mrs. Knauer and the President's Committee on Consumer Affairs to try to be sure that we can do everything we can as a major trade association to protect the consumer.

The one thing that makes our business different from other businesses, such as the furniture business, or appliance business, the one thing that makes ours different is that we deal with all of these people who make the many products which go into a house. The builder buys the products from the subcontractors, be they major manufacturers or little businessmen. We are looking into just what we can do as a trade association to protect the consumer and make the consumer aware. We have gone into a very comprehensive—we had the Yankolovitch people do a study for us.

Chairman PROXMIRE. This is all very good to hear. The reason I raised this point is not because I do not think highly of your organization. You know that I do have a great admiration and respect for you and you have beeen most helpful to the Congress. But, this is something that the Government by itself cannot do and it needs assistance and your organization can help greatly. When there is this kind of a shocking record and I think we have sufficient documentation so that we all know there is shoddy workmanship in many, many areas, we need to be tough, and crack down more than we have.

Mr. WARANCH. The National Association of Home Builders is a federation of local associations and we have some of our local associations right now who are being sued because they expelled, or however you want to put it, people who were members because of shoddy workmanship.

Chairman PROXMIRE. Good for you. I am sorry you are being sued but I am glad you are cracking down.

Mr. WARANCH. I would like to make one statement to you, and that is with respect to the Forest Service. In light of all of the information that I have given you, and that you have read concerning prices of

lumber, there is some information that the Forest Service is considering cutting down on the allowable cut. And this is something——

Representative CONABLE. What?

Chairman PROXMIRE. Reducing the cut.

Mr. WARANCH. Reducing the allowable cut.

Representative CONABLE. As a result of pressures from environmental groups?

Mr. WARANCH. Yes. If this is true, it is really going to compound our problem and I do not know what the Congress can do about it, but I certainly hope that you will make or take judicial notice of this and look into it.

Representative CONABLE. Well, may I say one thing?

I cannot understand why we have such a backlog of reforestation at ths point. That is incredible to me. It has nothing to do with special interests or pressure groups. It seems like a tremendously foolish way to cut back on Government expenditures, if that is what we are cutting back on. I believe you could probably add $40 million to the budget for reforestation and still not use up the backlog of reforestation necessary. That compounds our erosion problem, it means that we are going to have a shortage way off into the future, and it just does not make any sense at all.

Mr. WARANCH. It is so short-sighted, it really is.

Chairman PROXMIRE. Although you may disagree with Mr. Wallace's numbers and you seem to have done so in your statement, the return on 236 at the end of the project months, in analyzing he finds the rates quite high and more importantly, the incentives do not seem to be geared for good management and long-range retention. That was one of the points made by GAO, as you know. After 10 years they just lose interest. Do you have any suggestions on reform of the standards?

Mr. WARANCH. I am going to let Mr. Coan talk about that if I may. We had a big discussion about that this morning.

Chairman PROXMIRE. All right, fine.

Mr. COAN. Senator, we are not sure whether there will be disincentives after 10 years. We know what the tax implications are and that is, that after 10 years you are entitled to full capital gains tax treatment of any moneys realized in excess of your depreciated basis when you sell the project, which would probably be a good reason for selling the project and having someone else start over again. This is what was in mind in 1968 when the 236 program was structured along with the roll-over provisions which were written into the tax laws in 1969. But, during the first 10 years there is a definite disincentive to let the project go to pot, because, if you do, you are liable to go into foreclosure, with an excessively high recapture situation which, in effect, might put you at a net loss situation, let alone a very low return. I think a lot of speculation is abroad about what is going to come down the pike in 1979, 1980 and 1981, that is what we are talking about. We are not talking about today because there is a definite incentive to keep the project maintained and going. Or you are liable to lose a lot of money.

Chairman PROXMIRE. But incentives after the 10 years?

Mr. COAN. No, sir, there is a lot of speculation about what might happen in 1979, and 1980 and 1981.

Chairman PROXMIRE. That is what concerns us. We may not be in the Congress then but——

Mr. COAN. No, but we do not know for sure that this is what is going to happen. We are speculating that those individuals running those projects might walk away from them at that time. We do not know that that is going to happen.

We think that there is a strong possibility that roll-over will occur as provided for.

Chairman PROXMIRE. What I would like to ask, would you think about this and perhaps you are not prepared to give specific recommendations now, and maybe you are, but any recommendations you have for changes in incentives that would improve the situation would be very helpful to us.

Mr. COAN. I think that we would prefer to do that. We have not thought about changes in incentives because at this time we are not sure they are needed. We are not saying they are not needed either. I do not think the case has been proven either way on the matter.

Chairman PROXMIRE. GAO study indicated a pretty emphatic conclusion on their part and they can be wrong, that they are going to get into some real problems with our present system because of the fact that the incentives disappear.

Mr. COAN. Well, let me make one further comment. The incentives that will disappear are no different than the incentives that disappear with respect to regular rental housing under the existing tax laws as they existed up to 1969. But, I do not think there is any strong record of walking away from nonsubsidized, moderate-income projects like those built in the mid and late fifties under the then more liberal tax laws than we no whave in effect.

Chairman PROXMIRE. All right. I would appreciate it if you would consider that and give us any further thoughts you have.

Congressman Conable.

Representative CONABLE. No questions, Mr. Chairman.

Chairman PROXMIRE. Gentlemen, thank you very much. We appreciate your presentation, and I did not mean to be critical of your organization. But I thought that you would want to respond to the manv criticisms we have gotten of the 235 and 236 programs.

Mr. WARANCH. We certainly welcomed this opportunity.

Chairman PROXMIRE. Thank you.

The subcommittee stands adjourned.

(Whereupon, at 12:45 p.m., the subcommittee was adjourned, subject to the call of the Chair.)

APPENDIX

NATIONAL RURAL HOUSING COALITION,
Washington, D.C., December 13, 1972.

Senator WILLIAM PROXMIRE,
Chairman, Joint Economic Committee,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: The National Rural Housing Coalition is made up of citizens and organizations concerned about the lack of adequate housing and housing programs for low income people in rural America. One measure of that concern was our sponsorship, along with others, of the Second National Rural Housing Conference here in Washington the last week of November. (The Coalition was born at the first Conference in 1969.) More than 800 people from 46 states, Puerto Rico, Virgin Islands and the District of Columbia attended, and we believe that that response indicates the rising awareness, in all parts of the country, of the need for more and better housing in rural areas.

The Conference program was divided into three main areas: Land for Rural Housing; the Mythology of Housing; and Building and Paying for Housing. Major papers were presented by experts in the various areas. Mr. Chairman, we believe these papers are worthy of consideration by the Committee in connection with your hearings on housing subsidies and housing problems, and respectfully request that they be made a part of the record of those hearings. The authors and papers are:

Henry Aaron—Rural Housing Need.
Richard J. Margolis—The Tragedy of Rural Housing: Notes Toward an Understanding of the System Behind the Shacks.
Peter Barnes—Ownership Concentration, Speculation, and Access to Land.
Welton Barton—Federal Role—Land Use Controls.
George Rucker—Land and Taxes.
Eduardo E. Lozano—Housing Costs in Rural Dwelling.
Cushing N. Dolbeare—Housing Subsidies.: Why Pays and Who Benefits.
Paul E. Noll—New Technology—Solution or Sedative.
Leon Keyserling—Economic Growth and Social Purpose.
Gordon Cavanaugh—Developing a Responsive Public Delivery System.
Clay L. Cochran—Toward a National Federalism.

Very truly yours,

ROBERT E. JOHNSON,
Chairman of the Board.

JANUARY 16, 1973.

Mr. ROBERT E. JOHNSON,
Chairman of the Board, National Rural Housing Coalition,
Washington, D.C.

DEAR MR. JOHNSON: I want to thank you on behalf of the Subcommittee on Priorities and Economy in Government for the material you submitted for inclusion in the Subcommittee's record on housing subsidy hearings. I have looked at all these papers and found them to be useful and interesting. Unfortunately, some of the papers overlap other information we have already obtained, and other papers take us too far afield from the direct issues of housing subsidies. For that reason, we have decided to include only the following papers in the record of the hearings.

Henry Aaron, "Rural Housing Need."
George Rucker, "Land and Taxes."
Gordon Cavanaugh, "Developing a Responsive Public Delivery System."
Clay L. Cochran, "Toward a National Federalism."

Thank you for your assistance in bringing this material to my attention.

Best regards,

WILLIAM PROXMIRE,
Chairman.

SECOND NATIONAL RURAL HOUSING CONFERENCE, WASHINGTON, D.C.
NOVEMBER 28, 1972

RURAL HOUSING NEED

(By Henry Aaron)

Five years ago, the President's Commission on Rural Poverty titled its report *The People Left Behind.* That title remains a fitting one. Rural Americans *have* been left behind by the concentration of population—and, more importantly, by the concentration of economic and political power—in the great metropolitan centers. In virtually every indicator of social and economic well-being, rural Americans lag behind. And they have been left behind by the programs of their government—almost across the board, certainly in the field of housing.

Despite decades of rural-urban migration and a slow-but-steady rise in the number of nation's counties which are a part of a Standard Metropolitan Statistical Area (SMSA), nearly a third of our population still lives outside of the metropolitan areas. They are less likely to have had the advantages of formal education beyond the eighth year of school; they are more likely to be under fifteen or over fifty years of age (and least likely to be in their peak earning years of 30 to 50); and—not surprisingly—they are far more likely to be poor.

Our official definition of poverty is designed to hide the facts rather than to illuminate them. It assumes that if you have as much income as you need to buy food for your family to live on an emergency diet, then three times that much income is enough for you to buy not only food, but housing (including all the aspects of it), clothing, medical care, transportation, and everything else you need (never mind what you might want)—if you have a cent over that, you're not "poor" according to the United States Government. But, even by this parody of a definition—which might better be called a measure of destitution than a measure of poverty—even by it, one out of every five households in the nonmetropolitan areas of the country is in poverty. Nearly one out of every three Chicano families in nonmetropolitan America is officially poor. And, every other Black family in nonmetropolitan America is officially poor!

Little wonder that we still have a housing problem in this, the world's richest nation. The Government keeps talking about how our housing situation is improved, but the 1970 Census showed that more than two decades after Congress promised "a decent home in a suitable living environment for every American family," nearly one out of every seven American households was still living in housing that was either substandard, overcrowded, or both. And we don't even know how many additional families are paying an indecent share of their incomes in order to occupy housing which at least meets that very minimum standard.

That one-out-of-seven ratio is based on the national average. In nonmetropolitan America, more than one fifth of the families live in substandard or overcrowed housing, and more than half of the Black families in nonmetropolitan America are in that situation. And, I am still talking about *national* averages. If you want to get still more specific, and just talk about the nonmetropolitan areas of the South, then you are talking about more than 63% of the Black households living in housing that is substandard, overcrowded, or both.

I note that the title for this morning's session is "The Rural Housing Crisis." But, as I told the McGovern Committee two years ago, the word "crisis" implies a temporary situation, and for the people living in the nation's worst housing, there is nothing temporary about it. Those people have lived in these conditions all of their lives, and their parents did so before them. It's not a "crisis"—it's a scandal that a country with a trillion dollar economy ought to be ashamed of.

Bad housing in America is a function of three major factors: how much money you have, what color you are, and where you live. If you're not destitute, and you're not a Chicano or a Black, and if you live in a metropolitan area, the chances are better than 98 out of 100 that your housing at least has adequate plumbing. If you're officially poor and you're a Chicano or a Black and you live in a metropolitan area, then the chances are more than 11 out of 100 that your housing doesn't have adequate plumbing. And, if you're poor and Black and live in a nonmetropolitan area, then the odds are better than even that your house is substandard by the Census definition.

In the years since the First National Rural Housing Conference we have begun to get the message across that rural areas and small towns not only have more than *their share* of the nation's bad housing, but just plain *more* of the bad housing. Now, we even have a high-powered consultant for the nation's homebuilders and savings and loans conceding that our subsidized housing programs have been

least effective in responding to the needs of the lower income people in rural areas. I'm not going to belabor the point—the statistics speak for themselves. I would just add that the evidence is clear from the Census figures that what progress we have had in improving the nation's housing—and, sure, there has been some: in the world's richest nation, there *ought* to be *some* progress—has been more rapid in metropolitan areas than it has in nonmetropolitan areas. In 1950, the Census showed that the incidence of substandard housing in nonmetropolitan areas was twice as great as in metropolitan areas; the 1970 Census shows that the incidence of substandard housing in nonmetropolitan areas is three times as great as in metropolitan areas. In relative terms, the rural areas and small towns are still being left behind.

Four years ago, the Congress finally got around to setting some numerical goals for housing in this country, and this year, the Nixon Administration claimed that we are achieving those goals—at least in total housnig, and provided we count trailers, which the original goals didn't assume we would. But those goals—and especially the goals for subsidized housing—were like our official measure of poverty: they were set with an eye to what might be politically acceptable. Even those estimates assume that we'll need to average more than 2 million new and rehabilitated units a year during the next ten years just to take care of new households, losses and deterioration from our present supply of housing, and allow for a normal vacancy rate. Since the '70 Census showed that we still have nearly 6 million substandard units and another 4 million households in crowded housing, it is clear that we need more like 3 million units of new and rehabilitated housing every year, if we are serious about eliminating housing need by the end of this decade.

That is only part of the story. The Congress took HUD's word for it that 6 million subsidized units over the ten-year period would be enough to meet the needs of people whose incomes aren't sufficient to buy or rent adequate housing on the private market. In fact, the households that are officially recognized as poor by the Government number close to 8 million now and are likely to still number more than 5 million by the end of the 1970's. And that is probably only half of the number of households who need financial assistance to secure decent housing without spending an exorbitant share of their income for it. The Bureau of Labor Statistics figures on what a minimum budget for living requires indicate that more than one fourth of the nation's households have inadequate incomes. That's nearly 16 million households, or—as I said—about twice the number officially designated as poor.

My friends at the Rural Housing Alliance have put the numbers together and they conclude that we not only need 30 million new and rehabilitated units during the 1970's, but that 10 million of those need to go into the nonmetropolitan areas. They have estimated that 13 million of those units need subsidy, and that 5 million of those should be in nonmetropolitan areas, with 3 million of that 5 million representing poverty-level households.

Now, the past two years have been record years for housing in the United States—averaging 2 million new starts and subsidized rehabilitations, plus another half-million mobile homes (if you want to count those). But, only a half-million of those have been subsidized, compared to that 1.3 million we need. And, in nonmetropolitan areas, the number of subsidized housing starts is even further short of the need—it barely equals one third of what we estimate is required.

One final note on the statistics comparing need and accomplishment. While at least half of the need is represented by poverty-level households, only a third of our current subsidized housing starts are under programs with a deep enough subsidy to do those poverty-level families any good. Again, the situation is worst in rural areas and small towns. There, even at current record program levels, we are only meeting about one fifth of the need.

The picture is—as it usually is—a mighty bleak one And, that's what this conference is all about. We're here to tell people, once again, how bad it really is—so they can't go on saying, "We didn't know it was that way." We're here to tell the Government that its programs haven't—and won't—provide "a decent home . . . for every American family" and we're here to tell them why they won't We're here to say loud and clear that the Federal government must not get out of the subsidized housing business, the way Secretary Romney is suggesting it should. We're here to say that it's time the Federal government got into the subsidized housing business and stopped abdicating its responsibility. We're here to talk about what it will really take to make good on that Congressional promise.

One more time!

TABLE 1.—ESTIMATES OF SUBSTANDARD AND CROWDED OCCUPANCIES IN THE UNITED STATES, 1970, BY RACE AND RESIDENCE, BY REGION

Households in thousands

	All areas		Non-metro areas	
	All households	Black households	All households	Black households
Northeast:				
All occupied units	15,482.8	1,279.4	2,977.0	47.7
Substandard occupancies	659.5	98.8	185.8	4.5
Incidence (percent)	4.2	7.7	6.2	9.4
Crowded standard occupancies	932.2	178.3	153.1	6.7
Incidence (percent)	6.0	13.9	5.1	14.0
North Central:				
All occupied units	17,537.2	1,283.9	5,919.6	70.7
Substandard occupancies	1,004.6	103.7	540.4	14.8
Incidence (percent)	5.7	8.1	9.1	20.9
Crowded standard occupancies	1,156.8	180.9	342.1	8.9
Incidence (percent)	6.6	14.1	5.8	12.6
South:				
All occupied units	19,258.2	3,110.2	8,401.2	1,297.4
Substandard occupancies	2,238.3	966.7	1,636.1	697.8
Incidence (percent)	11.6	31.1	19.5	53.8
Crowded standard occupancies	1,402.9	441.1	544.2	126.2
Incidence (percent)	7.3	14.2	6.5	9.7
West:				
All occupied units	11,171.5	506.7	2,288.9	19.6
Substandard occupancies	383.9	28.5	143.8	2.0
Incidence (percent)	3.4	5.6	6.3	10.2
Crowded standard occupancies	849.2	74.6	202.1	3.4
Incidence (percent)	7.6	14.7	8.8	17.3
United States:				
All occupied units	63,449.7	6,180.3	19,586.8	1,435.4
Substandard occupancies	4,286.4	1,197.8	2,506.1	719.1
Incidence (percent)	6.8	19.4	12.8	50.1
Crowded standard occupancies	4,341.1	874.8	1,241.5	145.1
Incidence (percent)	6.8	14.2	6.3	10.1

Note: Components do not always add to totals because of rounding.

Source: Based on Census Bureau, Census of Housing: 1979, "General Housing Characteristics," Final reports HC(1)-A1 through HC(1)-A52; substandard occupancies partially estimated by Rural Housing Alliance.

TABLE 2.—INCIDENCE OF INADEQUATE PLUMBING FOR BLACKS, CHICANOS, AND OTHERS, BY POVERTY STATUS AND METROPOLITAN/NONMETROPOLITAN RESIDENCE

	Metropolitan			Nonmetropolitan		
	Number of households (thousands)	Households with inadequate plumbing (thousands)	Incidence of inadequate plumbing (percent)	Number of households (thousands)	Households with inadequate plumbing (thousands)	Incidence of inadequate plumbing (percent)
Above poverty:						
White [1]	29,975.8	469.1	1.6	10,827.5	435.4	4.0
Black	3,135.7	139.4	4.4	584.4	177.2	30.3
Chicano [2]	1,452.4	40.8	2.8	214.8	16.6	7.7
Total above poverty	34,563.9	649.3	1.9	11,626.6	629.2	5.4
Poverty level:						
White [1]	3,357.6	235.7	7.0	2,317.0	428.1	18.5
Black	1,250.9	141.4	11.3	569.8	316.8	55.6
Chicano [2]	372.5	41.3	11.1	100.6	28.8	28.6
Total poverty level	4,981.0	418.4	8.4	2,987.5	773.8	25.9
Total white [1]	33,333.4	704.9	2.1	13,144.5	863.6	6.6
Total black	4,386.6	280.7	6.4	1,154.2	494.0	42.8
Total chicano [2]	1,824.9	82.1	4.5	315.4	45.4	14.4
Total all households	39,544.9	1,067.7	2.7	14,614.1	1,403.0	9.6

[1] All those not classified by the Census as Negro or Spanish heritage.
[2] Those classified by the Census as Spanish heritage.

Note: Data on households by poverty status do not cover all households; see source for details. Components do not always add to totals because of rounding.

Source: Census Bureau, "Census of Population: 1970," "General Social and Economic Characteristics," Final Report PC(1)-C1.

TABLE 3.—ESTIMATE OF HOUSING NEEDS IN THE 1970's, OVERALL AND IN NONMETROPOLITAN AREAS

[Millions of units]

	Total	Subtotal nonmetro areas	(Percent represented by nonmetro portion)
Housing stock at the beginning of the decade:			
Occupied units	63.5	19.6	31
Substandard occupancies	(4.3)	(2.5)	(58)
Crowded standard occupancies	(4.3)	(1.2)	(28)
Vacant units	5.2	2.8	54
Substandard vacancies	(1.3)	(1.0)	(77)
Total housing stock	68.4	22.4	33
Portion substandard	(5.6)	(3.5)	(62)
Housing output needed during the decade to meet various changes in the situation:			
New household formation	13.2	3.1	23
Return to normal vacancy level	3.7	.4	11
Replacement of standard units lost:			
Through demolition and other losses	2.5	.7	28
Through deterioration to substandard	2.7	1.3	48
Replacement of mobile home losses	1.7	.9	54
Total needs:			
To meet changes during the decade	23.8	6.4	27
To eliminate backlog of need:			
Substandard units	5.6	3.5	62
Crowded occupancies	2.0	.7	35
Gross housing needs	31.4	10.6	34
Reduction in need due to upgrading of formerly substandard units	1.4	.6	40
Net housing needs	30.0	10.0	33

Source: 1970 census and estimates by the Rural Housing Alliance.

TABLE 4.—COMPARISON OF HOUSING PRODUCTION AND HOUSING NEED

[Thousands of units annually]

	Total			Nonmetropolitan		
	Estimated needs	Fiscal year 1971–72 production	Ratio of production to needs (percent)	Estimated needs	Fiscal year 1971–72 production	Ratio of production to needs (percent)
Total housing output	3,000	2,537	85	1,000	849	85
Excluding trailers		(2,042)	(68)		(577)	(58)
Assisted housing output:						
Low-income category	650	174	27	300	62	21
Moderate-income category	650	363	56	200	106	53
Total assisted output	1,300	537	41	500	168	34

Source: Needs estimates based on table 3; total production for fiscal year 1971–72 from contruction reports (partially estimated); assisted production from HUD fiscal year 1973 Budget Summary and FHA reports; allocation of HUD-assisted units to nonmetropolitan areas based on analysis of various HUD reports and construction reports (assumes 42 percent of public housing units, 36 percent of rent supplement units, 14 percent of 235/236 units, and 11 percent of other HUD-assisted units go to nonmetro areas); assumes 84 percent of FHA units go to nonmetro areas (as indicated by data prepared for HUD–USDA Rural Housing Coordinating Group); division of assisted units between low- and moderate-income categories is on the following basis: all public housing, rent supplement, and farm labor units considered low income; 12 percent of FHA ownership and rental units considered low income; 24 percent of 236 and 8 percent of 235 units considered low income (based on characteristics of households served, as reported in HUD Statistical Yearbook).

SECOND NATIONAL RURAL HOUSING CONFERENCE, RAMADA INN, WASHINGTON, D.C., TUESDAY, NOVEMBER 28, 1972

LAND AND TAXES

(By George Rucker)

Land is the source of a "double-whammy" in housing costs, affecting both the acquisition of housing and the continued use of it.

In terms of the first aspect, the price of the lot is currently the fastest rising portion of the cost of acquiring new housing. The National Association of Homebuilders reports that over the last three years, the cost of developed land (on a square foot basis) has risen an average of 25% each year. Thus, even with lots getting smaller, more than one fourth of the increase in the average price of new housing in that three year period was attributable to the rise in the cost of the developed lot.[1]

This upward spiral in land values is not a recent or temporary phenomenon. A study done for the Douglas Commission concluded that between the mid-1950's and the mid-1960's, land value in the U.S. nearly doubled—from $269 billion in 1956 to $523 billion in 1966, an increase representing $5,000 per American family.[2] The share of national wealth represented by private nonfarm land has gone up dramatically in the last decade-and-a-half: from less than 9% of the total in 1952 to more than 13½% in 1968.[3]

Several things need to be remembered about this phenomenon. First, the ownership of land is almost certainly as maldistributed as income in this country. This means that the upward spiral in land value profits the wealthy most. Second, the rise in land values is basically a rise which is socially-generated—it results, certainly in the base of nonfarm land, from the growth of population and urbanization and the provision of public services and facilities which make land more valuable for use. In short, rising land values represent a form of speculative income, for which the recipient doesn't have to do anything except wait—and his return for that wait is a substantial one.

Four of the members of the Douglas Commission put it this way:[4]

> Someone once classified income into three divisions: earnings, findings, and stealings. This enormous increase in land values is most certainly not a stealing. . . . Men of the purest character have shared in these gains without loss of virtue. But if these gains are not a stealing, they are also most certainly not an earning. They are instead almost a pure finding. The increase . . . in the value of the land was not caused by the labor or abstinence of its owners. It was instead an unearned increment.

The tax structure of the U.S. favors speculative gain by taxing it only half as heavily as non-speculative income. Moreover, the land portion of real property tends to get taxed less heavily than the improvements on land. The Douglas Commission estimated that while land value represents about 40% of real property value, "only about 30 (rather than 40) percent of all property tax revenue from realty is based upon the land-value component of ordinary real estate."[5]

The obvious result of all this is not only to undermine the principle of progressive taxation to which we give lip-service in this country, but to encourage urban sprawl rather than more rational patterns of land use and development, and to discourage maintenance and rehabilitation of existing housing. (As is frequently pointed out, under the current tax structure, a landlord who makes substantial improvements in his property faces the prospect of increased taxes on it, which means that he will want increased rents to cover those taxes.)

To reverse this current anti-social pattern, the Douglas Commission and others have recommended that we consider increased land-value or site-value taxation, basing it on potential-use value rather than present-use value. This would encourage development of land rather than its retention for speculative gain. To the extent that it shifted the burden of the property tax from the buildings themselves to the land, it would reduce the present dis-incentive to upgrade housing. (As Henry Schechter points out, reducing the tax benefit currently available to capital gains in land would have impact similar to increased site-value taxation.[6])

As its proponents are among the first to recognize, the site-value tax is not without its problems. In the interest of equitable treatment of present owners

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[1] *Journal of Homebuilding*, October 1972.

[2] Allen Manvel, *Three Land Research Studies*, Research Report No. 12, National Commission on Urban Problems (Washington, 1968).

[3] Census Bureau, *Statistical Abstract, 1972*, Table 553, "National Wealth by Type of Asset, . . . 1952 to 1968" (Washington, 1972).

[4] *Building the American City*, Report of the National Commission on Urban Problems (Washington, 1968), page 395.

[5] *Ibid.*, page 385.

[6] *Property Taxation: Effects on Land Use and Local Government Revenues*, Committee Print, Committee on Government Operations, U.S. Senate, 92d Congress, 1st Session (Washington, 1971).

(many of whom will not yet have realized any speculative gain), it is frequently suggested that the tax either be implemented gradually or confined to future rises in land value. It is also pointed out that immediate application of land-value taxation might have the effect of forcing owners of low-income housing, particularly in the inner cities, to convert their holdings to non-residential (or to luxury apartments), thus reducing rather than increasing the available supply of lower-income housing.[7] But, these are problems that can be handled in the design and administration of the tax. The basic point is that such a reform in the tax structure would at least begin the process of retaining for society those values that society itself creates in land, and by reducing or eliminating the speculative element at least retard the upward spiral in land prices.

By itself, there is no reason to believe that site-value taxation would solve the problem of access to land for low-income housing—particularly not if it is applied only to future increases in value. It would presumably make the market mechanism more effective in determining land-use patterns, but those patterns would still be dictated by dollar values rather than social values. To meet this problem, there remains the need for more direct intervention by the public sector. That need stems not only from the already high cost of land for housing, but also from the need to assure its availability on a nondiscriminatory basis, not to mention the need for assuring other social values in patterns of land use.

The urban renewal program already represents a form of direct intervention both to dictate use patterns and to absorb the costs involved in over-riding the dictates of the market mechanism. But, here as in most aspects of our economy, we pay an extremely high price for our prejudice against public ownership. The public pays the price but lets the private sector appropriate whatever monetary gains subsequently flow from the action. Our approach to new communities is similar. The public sector takes on the risk and provides whatever additional subsidies are required to allow private development on a more planned basis, but the returns from that development go to the private sector. This is not only inequitable from the public standpoint, but it keeps the price tag so high that the scale of intervention is almost certain to be far less than the situation requires.

Since the cost of land is such an important component of total housing costs and since the point of any housing subsidy program is to bridge a gap between housing costs and ability to pay, it seems obvious that it is more economic for the government to pay for the land cost portion of the subsidy once directly rather than to keep paying for it indirectly, year-in and year-out, through subsidies on behalf of the occupants either to the owners or the financiers of the housing. By retaining ownership of land or low-income housing and utilizing long-term leases, the government could almost certainly recover some of its outlay and reduce its total subsidy costs. The initial investment required is substantial but not any more so than current continuing subsidy costs. Bernard Weissbourd has pointed out that, at an estimated land cost of $3,000 an acre, a $3 billion investment in land acquisition by the government would mean 1 million acres and that this, at an average density of 20 persons per acre (below that characteristic of present day surburban subdivisions), would provide the basis for housing 20 million people.[8]

We would do well—in this, as in other aspects of housing assistance—to take a few tips from the Western European nations that exhibit less paranoia about socialism. Sweden is, perhaps, the best example. The law there recommends that all municipalities "acquire land to the extent that they would have a dominating influence on the supply of land likely to be used for community development within the foreseeable future." And the local governments generally retain the ownership of that land.[9]

So much for the first aspect of land's double-whammy on low-income housing. If the cost of acquiring land for housing is the fastest rising component of costs, the price for keeping it—i.e., the property tax—is the second fastest rising component of continuing housing costs. According to NAHB, property taxes have risen an average of 10% a year over the last three years. Only the price index

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[7] For an extended discussion of the pro's and con's of site-value taxation, see *Property Taxation, Housing, and Urban Growth* (Urban Institute, Washington, 1970).

[8] Bernard Weissbourd, *Satellite Communities: Proposal for a New Housing Program* (Santa Barbara Center for the Study of Democratic Institutions, 1972).

[9] See "European Urban Land Policies," *HUD International Information Series 11*, September 1, 1971.

for maintenance and repairs has gone up more steeply.[10] Estimates reported by Schechter show that property taxes take a steadily increasing share of income. In 1960, 36% of nonfarm homeowners paid less than 2% of houshold income in real estate taxes, the average household paid 2.7% and 22% paid 5% or more. In 1968, the share paying less than 2% of income had dropped to 26%, the average household was paying 4%, and almost 36% were paying 5% or more.[11]

Those are national average figures. In New Jersey, which has no state income tax and instead levies stiff property taxes, the picture can be particularly bleak for low-income homeownership. In Lawrence township in nonmetropolitan Cumberland County, the property tax bite on a house with a sales value of $15,000 is $780 a year[12]—one-and-a-half times as much as a Farmers Home Administration borrower with maximum interest credit would have to pay on his loan each year. In other words, assuming that a moderate-income family could find a decent house for $15,000, even with the maximum subsidy FmHA could afford on interest, that family would need an *adjusted* income of more than $6,500 a year to be able to afford principal, interest, and taxes with 20% of that adjusted income. (Cutting the tax bite in half would reduce the adjusted income required by about $2,000.)

While some economists debate whether or not the property tax is *inherently* regressive in its nature, there seems no question but that, as currently administered, it is regressive. Statistics used by Dick Netzer showed that taxpayers with adjusted gross incomes of between $3,000 and $7,000 reported real estate taxes averaging 3.6% of their incomes, while taxpayers in the $20,000 to $50,000 income class reported real estate taxes averaging only 2.3% of income.[13] When one additionally takes into account the fact that real estate taxes can be deducted from income for Federal income tax purposes, the regressivity is intensified, and the *effective rate* paid by the upper income category drops to less than half that paid by the lower income category.[14]

The pressure for property tax reform has been increased by recent court decisions holding that reliance on the local property tax to finance education is discriminatory, providing the wealthy suburbs with greater resources at a smaller tax rate—at least in relation to income levels. (Data published by the Urban Institute contend that the local property tax rate for education is highest on the average in the suburbs, least in the central cities.)[15] The point is that the cities have a substantial base for the property tax, but must finance substantial levels of other services from that base, while the suburbs are better able to tax their property for education, since they don't have other municipal services to finance on the scale of the central cities. Given their higher income levels, it is also true that a higher property tax rate in the suburbs takes less of a bite out of incomes than even the lower rate in the central cities. Rural areas and small towns have the worst of both aspects. With lower per capita incomes and with a smaller tax base, they require the highest property tax rate to provide education revenues on a comparable per pupil basis.

These figures bring into question the desirability of reducing property taxes by having the Federal government simply pick up an increased share of the financing of education, especially if it is to be paid for by anything as regressive as a value-added (i.e., sales) tax, as initially suggested by the Nixon Administration. The Urban Institute figures suggest that such a "reform" would in fact have a markedly pro-rich bias. While any shift of the cost of financing education—or other municipal services—from the property tax to a more progressive tax, whether Federal, state or local, is desirable, I would suggest that we need not abandon the property tax out of hand. It could, itself

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[10] *Journal of Homebuilding*, October 1972.

[11] *Property Taxation, op. cit.*

[12] Based on data from Local Property Tax Bureau, Division of Taxation, State of New Jersey.

[13] Dick Netzer, *Economics of the Property Tax* (Brookings Institution, Washington, 1966), Table 3–6, page 49.

[14] *Ibid.* Netzer's figures are based on 1960 tax returns. More recent figures on the value of the deductibility of property taxes from Federal income taxes show that this loophole is worth about $6 to the average taxpayer in the $3,000 to $7,000 bracket, but worth $219 to the average taxpayer in the $20,000 to $50,000 bracket. See *People and Taxes*, Vol. I, No. 5.

[15] Levin, Muller, Scanlon, and Cohen, *Public School Finance: Present Disparities and Alternatives* (Urban Institute, Washington, 1972).

be shaped into a more socially-rational structure. The major elements of such a reform, it seems to me, would include these:

(1) Removing the speculative gain from land values by an increase in land taxes which would retain for society the increased value which society generates.

(2) Ending the balkanization of property tax jurisdictions which allows wealthy areas to key rates to their own local needs, rather than carry a fair share of the total public burden.

(3) Securing more uniform administration of the property tax so that there is an end to the wide variations in assessment practices that are now characteristic—and to situations where an underpaid local tax official has to do battle with the minions of multimillion dollar corporations over what the latter should pay in taxes.

(4) Shifting the property tax from a proportional structure to a more progressive structure. At the very least, we should seek to relieve the burden on both low-income owners and low-income renters so that the property tax structure is progressive at the low-end, if not throughout the income scale.

(5) Providing incentives rather than disincentives to the maintenance and rehabilitation of housing which is available to lower income households.

(6) Reducing the number and extent of the exemptions from property taxes which currently benefit such institutions as the World Trade Center ("the world's tallest tax exemption") and similar buildings.[16]

These reforms relate only to the property tax itself. As has been indicated, the way in which speculative gains from property and taxes on property are treated in the Federal income tax structure also provides plenty of scope for reform in the direction of a tax structure that is truly based on ability to pay.

Second National Rural Housing Conference, November 29, 1972

"Developing a Responsive Public Delivery System"

(By Gordon Cavanaugh)

Introduction

To speak today about a low-income housing delivery system is actually quite similar to speaking about the kingdom of heaven—it is something we all have our own peculiar notions of, something we would all like to see someday, and something that is, at least for the present, definitely not of this would. A system, in fact, defined in the dictionary as "an orderly manner of arrangement or procedure," is the furthest thing from what actually exists in low-income housing. We have instead an arrangement that more closely approximates the definition of chaos. At HAC, we are working on a project to build a couple dozen homes that involves dealings with 4 federal departments, a couple of state and local agencies and a sprinkling of OEO-funded nonprofits, topped off by a technical assistance grantee to explain it all. What you need is a doctor in public administration rather than a builder. As has been commented—in housing, processing is the product and housing the by-product.

As we have already seen during this conference, low-income housing is delivered inefficiently. The wrong people are subsidized, driving up costs considerably, and the complexity of the existing procedures is self-defeating. But the delivery of low-income housing is also ineffective. Whole portions of the low-income population are excluded from participation in subsidized housing programs because these programs are shoddily designed half-way measures, and are unable to meet the needs of the very poor. Equally important, but less often heard, is that entire areas of the country are not benefitting from subsidized housing programs because of factors entirely extraneous to their actual need for subsidized housing. It is this particular aspect of low-income housing—the failure to assure that all areas and places have equal access to housing aid—that I would like to deal with here, because it so clearly affects rural areas.

The root of the problem

While a distinction should be made between housing subsidy programs, on the one hand, and the actual institutions or organizations that deliver the housing

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[16] See Alfred Balk, *The Free List: Property Without Taxes* (New York, Russell Sage Foundation, 1971).

subsidies, on the other, the legislation creating our low-income housing did not do so. Instead, it dictates what sort of institutions or organizations are required to use the various subsidies. A look at the four or five major housing programs illustrates this point, and identifies an important reason why subsidized housing is concentrated in a few areas, while many areas of high housing need have none at all.

The most important low-income rental programs of the Federal Housing Administration, section 236 and rent supplements, require that projects be sponsored by nonprofit or limited-dividend housing organizations. It stands to reason that where this type of sponsor does not exist, there are few FHA rental units or rent supplements. The virtual non-existence of such FHA programs in rural areas bears this out. The Farmers Home Administration rental program, section 515, aside from being underfunded and having no rent supplements, must be sponsored by a nonprofit or limited-dividend corporation, or a private individual. This means again that the right type of organization must exist, or an entrepreneur with sufficient knowhow and capital to cover equity and the 2% of project costs which Farmers Home requires all multi-family sponsors to have on hand for initial operating expenses. In both cases—236 and 515—many rural areas suffer because sponsors as required under the programs do not exist. The problem is compounded because the limited size and dispersion of the market eliminates sponsors from elsewhere.

Of the interest subsidy rental programs, only the Farmers Home farm labor housing allows sponsorship by a broad range of organizations. But the farm labor housing program is the most ridiculously underfunded program among the large number of underfunded housing programs.

The distribution of homeownership interest subsidies for low-income people under FHA Section 235 and FmHA Section 502 is also somewhat dependent upon private action in that neither HUD nor FmHA are active salesmen of their own programs. In many areas, especially rural areas, it has fallen upon local builders, housing development corporations, and OEO funded community action agencies to find eligible low-income families in need of housing, educate them to the programs, and guide them through the complex application process. Where these individuals or organizations exist, low-income persons might have an opportunity to obtain decent housing. Where they do not exist, many needy persons remain ignorant of the housing options open to them.

Clearly, then, existing interest subsidy and rent supplement programs are largely dependent upon the existence of certain organizations or individuals in the private sector, and this is a root cause of their failure to serve all areas. *Too many decisions regarding the distribution of subsidized housing are left to the private sector.* This has led to a situation where the provision of housing for the poor is dependent more upon such factors as private initiative and expertise, and good will or profit potential, than actual housing need.

All of these interest subsidy housing programs, moreover, with the occasional exception perhaps of FmHA farm labor housing and FHA rent supplements, actually serve largely moderate income groups, and at best skim off the "richest" of the poor. Even if the geographic distribution of subsidies under these programs was made more rational, large numbers of the poorest people would still be without the opportunity to obtain decent housing. Public housing, unlike the other programs in that it is a public program subject to public decisions, is the only program now serving large numbers of the poorest persons. But merely because it is a public program does not mean that its subsidies are distributed on a more rational basis than the others. Indeed, certain aspects of the program have made it equally haphazard in its distribution of housing units.

Since its inception in 1937, the public housing program has relied almost exclusively upon the local housing authority as its delivery mechanism. The option to establish a local housing authority is strictly a local one, and many localities have chosen to do without public housing even though a need for it could be demonstrated. A recent study undertaken by the Housing Assistance Council and the Rural Housing Alliance shows that roughly half of the nation's 3,141 counties and county equivalents, containing 36 million people, still had no public housing as of the end of 1971. Most of these counties are rural. The study further revealed that the actual need for subsidized housing in counties without public housing is as great or greater than in those counties with a public housing program.

The amount of public housing provided in a particular area or place, or whether this housing is provided for the elderly or low-income families generally, are also local decisions. Some housing authorities are created for the explicit purpose of *not* building public housing, while others have not initiated a new project in 15 or 20 years regardless of increased local need. In still other areas, housing authorities are providing a disproportionately large share of elderly housing and neglecting the needs of low-income families generally. Ninety-two percent of the public housing in non-metropolitan areas of Nebraska is for the elderly.

Another major problem with the public housing program is that existing authorities most often have restricted jurisdictions, such as incorporated towns, villages and cities. This leaves large rural areas uncovered by the program. There are, of course, alternative public housing authorities in some states, such as county or regional authorities, but these are not now widely used.

We thus see again, in an essentially public program, an uneven and irrational distribution of assisted housing due to factors which have nothing to do with the actual need for such housing. The problem with the public housing program is not that decisions are left to the private sector, but that decisions are made by thousands of local governments. *The fragmentation of this decision making power among so many units of local government, without the responsibility and power of oversight review vested elsewhere, does not assure that housing decisions will take into account the needs of the poor.* In fact, it has often assured just the opposite, and allowed the distribution of vitally important housing subsidies to be subject to local whim, prejudice, ignorance, or just plain lack of initiative.

With legislative provisions requiring *local* creation of a housing authority, *local* approval of preliminary public housing loans, execution of a *local* cooperation agreement, and explicit *local* approval of Section 23 leased housing, the public housing program is the most blatant example of how local control may frustrate the solution to a problem that is essentially not local in nature. There is also, as you know, a local approval requirement for FHA rent supplements, and those of you who followed the omnibus housing bill this year were glad to see it die on at least one count. That bill would have extended the local approval requirement to include FHA Section 235 projects of 8 units or more and all FHA 236 projects.

Aside from these explicit local controls over the low-income housing, there is of course the more subtle and frequently abused power of zoning. But there is no need for me to reiterate what has already been said here about the misuse of zoning powers.

What *is* necessary is to ask ourselves by what right does a local government refuse to consider the housing needs of its low-income people, when the means for meeting those needs are at least partially available in the form of federal assistance? Of course, there is not such right at all; not morally, and perhaps not legally either. There has been no greater perversion of our democratic ideals than the hypocritical invocation of "local government control" to support some of our most undemocratic actions.

It appears, then, that low-income housing is now delivered in a haphazard and irrational manner. Reliance on private institutions and the existence in some important programs of what amounts to a local veto power have prevented an equitable distribution of low-income housing. *But the fundamental reason why this situation exists is that there is nowhere centered the responsibility to see that all areas and places are receiving subsidized housing at least in proportion to their need.* Where should this responsibility lie? If the failure of existing programs to distribute housing assistance equitably stems partly from reliance on private institutions, then the responsibility should be public. And if this failure is also due to local governmental inaction, then the responsibility should be placed at the state, and ultimately, the federal levels.

Housing as a public responsibility

In a recent study for HUD, an English housing expert gives his views on the American low-income housing situation. He notes that most Americans he spoke to were surprised that local governments in England willingly accepted, and I quote him here, "the primary responsibility for tackling the housing problem and for dealing with homelessness in their area." He believes that public responsibility of this sort is desirable in this country also, but admits to not understanding what is "politically practicable."

We, of course, do understand the politics of housing the poor, and why this task has not been accepted as a public responsibility. For one thing, it is a very expensive undertaking, and spending public monies on the poor is currently the most unpopular of issues. The federal government has consistently shown itself to be unwilling to provide the funds necessary to even scratch the surface of the housing need. (When the Lord separates the sheep from the goats, there would seem to be little question where the U.S. government—and OMB especially—will be placed.) Today perhaps one needy family in seven can expect some housing aid.

Housing is also highly political insofar as numerous localities prefer that their residents are neither poor nor members of racial minorities. Therefore, when responsibility has been accepted by a public body to provide low income housing *wherever* it is needed—witness the New York State Urban Development Corporation in Westchester County—it is often heatedly opposed. But where such a public body does not exist many communities never even reach the stage of overt opposition because they can freely ignore the housing needs of the poor. These communities are the ones, as we have all seen, that not only enact restrictive zoning and building ordinances, but which also fail to create housing authorities or other institutions to provide low income housing. Staff members of the nearby Montgomery County, Maryland, housing authority like to tell visitors that the largest hurdle they had to face before creating the housing authority was to get the county commissioners to admit that poverty existed in their county.

Either policy—overt opposition or subtle disregard—serves only to let misery go unchecked, further depopulate rural areas, and aggregate the process of "ghettoization" afflicting our metropolitan areas. The explicit acceptance of a public responsibility to house the poor *wherever* it is needed implies an end to these selfish prerogatives now exercised by many communities.

This is the politics of low income housing.

It is these very aspects of low income housing, though—the great expense and the failure of individual communities to act—that make an expanded public responsibility necessary. Only the federal government can provide funds sufficient to adequately house the nation's poor. And only the federal and state governments can effectively encourage localities to meet their low income housing needs and enact measures to overcome local opposition.

What we come to here, then, are the rudiments of what I started out to discuss—a low income housing delivery system. The first element of this system is a federal commitment of funds adequate to meet the housing needs of the poor. This means *all* of the poor, not just one family in seven. It also means that housing subsidy should be deep enough to serve the poorest, and that unlike the existing low income housing programs no families will go unaided for the absurd reason that they are too low income. The simplest and most economical way to meet these funding needs is through a system of direct federal funding ranging from full capital grant to direct federal loans at flexible interest rates.

The second element of this system is the creation of a comprehensive series of public institutions at the local and regional level which cover all areas of the country and which are capable of providing a wide range of housing services. The creation of these institutions, now largely a local option, must be approached in a more aggressive manner and the responsibility for their creation should be placed initially at the state level, and then at the federal level as a hedge against even state inaction.

Finally, there must be somewhere placed the authority and responsibility to see that the established housing agencies *can* and *do* provide low income housing whenever and wherever it is needed. Again, the initial responsibility should be at the state level, but it would be naive to suggest that active federal oversight review would not also be necessary.

These three elements, if pursued, would be a radical departure from existing policy only insofar as they would be effective in providing housing. The basic framework for all three actually exists at this time. It is the public housing system.

Public housing as a model

Whatever any of us think about the problems and deficiencies of the public housing program, and there are many, I think we all must admit that certain aspects of the program offer more potential for housing the poor in a simple, systematic way than any other program now in existence. Put another way, the public housing program can serve now as a model, admittedly imperfect, from

which we can build a more effective low income housing delivery system in the near future. But for those of you who doubt this, and I'm sure there are quite a few, let me outline what is good about the public housing program.

For one thing, it is the only program consistently able to serve the very poor. This ability stems from its method of direct federal capital grants, and the recognition that operating subsidies are also often necessary because many families are able to pay only token rents with a reasonable portion of their income. *In other words, public housing legislation as it is now written recognizes that housing subsidies must go as deep as necessary to assure that no family, no matter how poor, is denied the opportunity to live in good housing.* Of course, we all know that what the law says and what this administration practices are not the same, as evidenced by OMB's refusal to give public housing the amount of operating subsidies necessary to house the poorest persons. Nevertheless, this concept is still contained in the law, and it should be our task to see that it is not only protected from further erosion, but expanded to become the cornerstone of a housing subsidy program. We should promote the basic principle that housing subsidies must go as deep as necessary to provide housing for all those in need, and we should use this principle as a substitute for the specious reasoning that would have us believe we can house the poor without spending money. It is this reasoning that has produced so many absurdly complicated programs which cost much but do little for the poor.

A second aspect of the public housing program valuable in terms of creating an effective delivery system is that the institutional base already exists or the necessary legislation is available. Housing authorities now exist in many areas, and all states have enabling legislation. With slight revisions in legislation, both state and federal, housing authorities could become just the type of multi purpose housing institutions necessary to develop an effective public responsibility in low income housing. Perhaps most important, housing authorities can be created on county, regional and even state levels, all of which are more adapted to the needs of small towns and rural areas than are the smaller local housing authorities.

Finally, the public housing program, insofar as it relies on public bodies created under state legislation, allows the states to take a more aggressive role in creating housing authorities and seeing to it that they are responsive to local needs. A number of states already have realized that their responsibility in this area goes beyond merely passing the legislation allowing localities to create housing authorities. Seven states have created state housing authorities to serve areas where authorities do not exist, and two of these state authorities have the powers to oversee the activities of local housing authorities. An equally interesting development occurred in the State of New Mexico, where the legislature created regional housing authorities to cover the entire state. Of course, this type of state activity is only a start, and much stands in the way of a really effective state responsibility in low income housing. For example, states may create as many state or regional housing agencies as they like, but HUD won't fund any public housing without local government approval. There is also the reluctance of states to deal with the volatile issue of local zoning powers. These impediments will be dealt with eventually, however, and in the meantime many states are demonstrating a willingness to accept more of a responsibility in low income housing, and the public housing program is an ideal place for them to begin.

What I am proposing here, then, is not necessarily the public housing program as it now exists, but a new, improved and expanded version based upon the worthwhile aspects of what now exists. Its fundamentals are an adequate supply of deep subsidies, a system of publicly created housing agencies covering all urban and rural areas, and an ultimate responsibility vested elsewhere than individual localities to see that housing is provided wherever and whenever needed. This is a low income housing system able to fulfill the 25 year old pledge of the Congress of "a decent home and suitable living environment for every American." If Congress and the Administration are unwilling to implement such a program—unwilling to accept a public responsibility to provide housing for the poor—then they should at least have the honesty to change their rhetoric to "a decent home and suitable living environment for every American who can afford it."

The creation of an effective public responsibility in low income housing requires a number of changes, not the least of which is a change in attitudes at

the federal level. These changes must be implemented at the state and federal level, in both legislation and administrative policy. Allow me to outline here a number of steps which can be pursued immediately.

Understand that these proposals are not in any order of priority, but are all part and parcel of a unified approach to the problem.

Notes for a program

(1) To begin, *we must wipe from the books all existing housing legislation and start afresh with one greatly simplified housing subsidy program flexible enough and deep enough to serve all those in need.* Such a program would use direct federal money in the form of capital grants and low-interest loans. The former are often the only way to serve the poor, and the latter are a more economical use of federal funds than is subsidizing private banking institutions. In many instances a combination of grant and loan money could be used. Costly, bank-subsidizing interest subsidies would end.

All housing subsidies would be based upon a family paying a reasonable percentage of income, that is, an amount which recognizes the additional needs for food, clothing, health and recreation. And this does not necessarily mean the 25% figure now used. This figure is often much too high in the case of very poor families.

Under this simplified subsidy system, eligible families can rent or buy or be part of a cooperative or condominium, just as these options are now available in the public housing program. A limited portion of the funds could be available for direct housing allowances for emergency situations and where, in a given locality, decent, open housing opportunities exist.

Finally, the simplification of housing subsidies should also be directed towards simplifying the system of institutions necessary to deliver them. The unnecessary distinction between public authorities and nonprofit and limited-dividend housing developers found in existing legislation has greatly impeded the response to housing needs in many areas. In the future, public authorities should be permitted to provide all available housing subsidies to low-income people, because in many areas this will be the only way to deliver the subsidies.

(2) Of course, a housing program that looks effective on paper is nothing unless it is supported by a sizable commitment of federal funds. *These funds could be provided in the form of a national housing development trust fund, the start of a capital budget, and they should be provided in an amount adequate to house all those in need.* While we now have a goal of 6 million low income housing units by 1978, which we are already failing to meet, there is not commensurate commitment of funds over this period of time to assure that the goal is met. Instead, we see the confusing spectacle of a stated housing production goal but a Congress that tries to decrease housing appropriations and an administration that impounds such funds as are appropriated.

The amounts of funds needed to do the job is indeed huge, but it is not unreasonable to expect that they be provided. For example, look at our interstate highway building program. In 1956, the Interstate System and Defense Highway Act set 1972 as the completion date for what we know as our interstate highway system. The system is now 80% complete, *at a cost of $50 billion since 1956, a cost higher than OMB's estimate for the 5 million unit target. Why can't we have this type of commitment and performance in housing the poor?* God knows we have more than enough highways, and all too few good houses. But then the highway act was called the "Defense Highway Act" and we know anything phrased this way will get all of the funds it needs. I suggest right now that we title the next housing bill to come out of Congress the "*Housing Act for a Strong National Social Defense*". We might get somewhere then.

In any event, without affirmative federal action in setting aside a sizable commitment of funds which can be relied upon over an extended period of time, we will continue to establish unattainable goals and to spout empty rhetoric.

(3) Given subsidy programs that can work, and enough money to support them, a very important task is the creation of a comprehensive system of housing agencies to cover all urban and rural areas. These could take a number of shapes, but could all be created under the public housing authority enabling laws. There could be metropolitan or city-county housing authorities for the larger cities, regional housing authorities for small towns and rural areas, and even state housing authorities for smaller and preponderantly rural states. While all of these authorities may now be created under most state laws, the mere existence of en-

abling legislation has proven not to be enough, and a more aggressive approach is necessary. This approach requires a coordinated effort of the states and the federal government to create and support the necessary authorities.

For example, as mentioned, the New Mexico legislature created 6 regioinal housing authorities to cover the entire state, but with a specific mandate to serve small towns and rural areas. Other states could follow this example, or create statewide authorities to serve the same areas.

Such actions by the states require more encouragement at the federal level in the form of financial support and some assurance that the housing agencies created will be recognized as the responsible low-income housing producers in their state or area.

All of this has a very close analogy in what we have seen with the A–95 review system and its goal of creating state and sub-state district planning and review agencies. This entire program stemmed from a vague mandate in the Intergovernmental Cooperation Act of 1968, was outlined in an administrative memorandum of OMB, and was encouraged by HUDs 701 planning grants and an assurance by the federal government that state and regional planning bodies would have considerable influence on the distribution of federal funds within the state. Today, all states have state level planning bodies, and roughly 45 states have at least designated sub-state planning regions and many have created regional planning bodies.

The creation of regional or state housing agencies should be dealt with in the same way. The next housing bill to come out of Congress should require that HUD encourage the creation of a comprehensive system of regional or state housing agencies. The federal government should supply the initial operating funds for these regional and state housing agencies as in the 701 planning program, with a required local contribution. Finally, these agencies should be recognized at all levels of government as the cornerstones of the low-income housing effort.

We have thus far, then, subsidy programs that can serve the poor, a realistic commitment of funds, and the institutional framework necessary to deliver the housing. But even this is not enough to do the job.

(4) A number of changes are needed in existing legislation, and increased regulatory and oversight powers are necessary at the state and federal levels in order to make the system work. *A first priority is to remove all local approval requirements for housing subsidies.* As long as these requirements exist it will not really matter that housing agencies are created or programs funded, because local governments can prevent construction within their jurisdiction. The very idea of a local veto of an attempt to alleviate the plight of the poor is undemocratic at best and repulsive to the Judaic-Christian traditions we otherwise solemnize. This is not to say that localities do not have a legitimate planning interest in the location of subsidized housing. But this interest is not for the purpose of exclusion; it is to insure that the subsidized housing provided is the best available and decently located.

Once having done away with local approval requirements in housing programs, the machinery must be set up to deal with local abuse of zoning powers and building permits. Some states have already realized that these powers can be just as effective in excluding subsidized housing as an outright veto. The New York Urban Development Corporation is not bound by local zoning or building powers, and Massachusetts has created a state administrative appeals board to handle discriminatory zoning complaints. Both of these examples suggest possible avenues to approach the problem.

As in New York, state level housing authorities could be created and empowered to override local powers over housing construction and to exercise the power of eminent domain on a statewide basis. These powers could be based upon a broad regulatory capacity to oversee local responses to low-income housing needs. The state authority would ideally point out deficiencies in the local response to localities and request that the appropriate local or regional housing agency address the problem. The state authority should still retain, however, the power to move in and provide needed housing in cases of local recalcitrance.

The second approach would be to create state level housing commissions as administrative agencies empowered to order the provision of decent housing, by whatever means, to anyone in need where the local or regional housing agency fails to fulfill its responsibility. Such housing commissions would also hear and settle disputes over zoning, building permits, and other impediments to construc-

tion as well as claims of failure of local agencies to act. Such an approach could even be expanded to include a federal housing appeals board to deal with such disputes at a higher level when state level action is contended. The use of administrative appeals agencies is very common in American government, as in labor-managment relations, transportation, and communications. A similar type of mechanism might be as useful in dealing with the problem of locating subsidized housng.

It might be that a combination of these approaches is necessary—strong state housing agencies to identify the need and encourage local response, backed by a housing appeals system whereby the state agencies can deal with local exclusionary practices and failures to act to provide low-income housing.

The purpose behind these changes is not to take all housing decisions out of local hands. In fact, active local participation in providing low-income housing could surely be welcomed. The purpose is to provide some means to deal with localities which are consistently unresponsive to the housing needs of their low-income residents. This irresponsible behaviour cannot be tolerated on any grounds. To prevent it we must not only empower responsible public housing agencies at other than the local level to oversee local housing activities and compensate for deficiencies, but we must also see that localities do not frustrate this purpose for illegitimate reasons.

Along these lines, our most important task to put this system together, and the most difficult one we face, is to deal with existing attitudes. People who do not consider welfare programs and civil rights enforcement unusual, even though these are purely public programs administered by public bodies at other than the local level, consider a similar public approach to housing unrealistic. This is because in these other two areas it is recognized that human rights exist, and that it is a public responsibility to protect and fulfill these rights. Why is not decent housing also a right? Why can't we *all* recognize, as is partly recognized by the welfare program, that our social and economic system has created and perpetuated a large class of very poor people, and that the system is therefore now obliged to see that they receive at least decent food, clothing, education, *and* shelter? Why can't we *all* admit that in the richest nation in history it is morally indefensible not to declare and enforce the basic right of all people to partake of at least the necessities of life?

Until housing is viewed in this light—as a basic and enforceable right—the programs we design will be ineffective in dealing with the problem.

Are there alternatives?

I'm sure there are quite a few here that now have several questions in your minds. You might be asking, for example, why I would emphasize an approach to low-income housing which includes public development, ownership and management, when so much current thinking revolves around housing allowances? Even Secretary Romney has recently suggested a federal withdrawal from subsidized housing and a complete reliance upon housing allowances. This proposal, however, besides being the only withdrawal the administration has called for, was only one of Romney's suggestions. He also proposed a number of alternatives along the lines of what I have suggested today, with particular attention to an increased responsibility for the states in providing needed housing.

As for housing allowances, they are by no means the panacea some suggest they are. For one thing, they would only be feasible where there now exists a high vacancy rate in standard housing. In rural areas, there is no stock of available decent homes.

Similarly, the vacancy rates in most large urban areas now hover around 1 and 2%, clearly not high enough to make a housing allowance system feasible. In the short run, it is quite certain that a housing allowance system would only tend to inflate housing costs, just as increases in welfare shelter allowances have resulted in higher rents, not higher quality. In the long run, the argument is that housing allowances will spur the private sector to increase production. This, of course, remains to be seen. In rural areas, it is doubtful that there exists the capacity for greatly increased production at this time—either the personnel or the necessary financing.

When we consider the costs of a housing allowance program it also becomes doubtful that it would ever be funded. For one thing, such a program must be strictly regulated to insure that the inevitable increase in housing costs also brings a corresponding increase in housing quality. This would require comprehensive programs of housing inspection and code enforcement if we are not

to find ourselves in the same situation as welfare agencies today—subsidizing substandard housing.

There is also the problem of racial and economic discrimination. Merely because a low income family can afford to live in a certain place does not mean that they will actually be able to live there unless there is strict enforcement of the fair housing laws. Without this enforcement, housing allowances do not insure the dispersal of low income families outside of the areas in which they are now concentrated.

The history of the very analogous program of leasing existing housing supports the concern that allowances will be costly to administer and will not open housing outside ghetto and deteriorated areas.

Finally, there is the cost of the program itself. The costs would be especially high because the program would rely on the private sector for the production of housing, and this includes the costs of private financing and profit. We are only now beginning to see the real costs of subsidizing the private sector to produce low income housing under the interest subsidy programs, and in the long run these costs will tend to be considerably higher than the direct government involvement in the production of low income housing, as in the public housing program.

My personal fear is that a housing allowance program, if used as a substitute for publicly-owned housing, would be as unreliable as the market is now in providing for the needs of low and even moderate income families. We would once again be putting the actual distribution of low income housing into the private sector to become dependent upon private decisions, and we would abandon our only opportunity to see that housing is distributed rationally and all areas and families are in fact served. There is also the very real expectation that, given the opportunity because of changes in local demand, private owners will always attempt to get increased rents for their dwellings and this will undoubtedly decrease the availability of housing for low income people even if they have a housing allowance.

This is not to say that housing allowances may not be feasible in certain areas and as a supplement to public development. In fact, they would be necessary and valuable. But as a substitute for public development they are nothing more than an easy means whereby the Federal Government can abdicate its responsibility to see that low-income housing is effectively delivered.

The abdication of this responsibility is clearly being considered by this administration. In the same speech wherein Romney proposed the complete federal withdrawal from subsidized housing, he suggested an alternative which would give states an unfettered block grant for housing, similar to revenue sharing. This would be as inadvisable as a complete abandonment of federal housing programs. Many people are already worried about the state use of revenue sharing funds, and most do not think they will be used for innovative, socially useful purposes and real priorities. If housing funds were distributed among states on the same basis, the same problems might arise.

At this time the Federal Government still has a very important role to play in providing low-income housing. Besides being the primary source of funds, it must monitor and regulate state housing activities, just as the state must oversee the housing efforts of its localities. It must continue to deal with fair housing enforcement, uniform codes, construction standards, housing costs, and other important regulatory matters. Most importantly, it must see that the states are in fact dealing adequately with their low income housing needs and, if necessary, be the houser of last resort. It would be unrealistic to think that we could leave full responsibility for low income housing in the hands of the states, without the possibility of federal intervention to deal with unresponsiveness.

Many of you, I'm sure, are quite skeptical of any housing program emphasizing a public responsibility. Why should I emphasize a public approach to low-income housing when so many of us have seen that housing authorities are often autocratic and unresponsive to the people they are supposed to serve, and when they often have all the failings of government generally? This is a very real problem, but hopefully one that can be dealt with.

The failure of government agencies and programs often reflects the failure of concerned people to involve themselves when necessary and bring pressure to bear. A public housing program and public housing agencies are just like all other governmental entities—they need public pressure to make them responsive. We all have the right to make public agencies fulfill their obligations and observe

the law, and it is often necessary to exercise this right under a public housing program.

Many modern industrial societies have long since adopted a comprehensive public system, and with considerable success. We must seriously consider whether our public housing program is in trouble because it is public, or because of the barriers we have put in front of it. The program did not demand unattractive and alienating high rise housing, but this is all that was feasible with the amount of money and land made available for housing the poor. The program also did not demand that the housing be concentrated in the worst neighborhoods. Our own racism did that. And it was not the program that required authorities to be unresponsive to tenants' needs, but a combination of racial attitudes and lack of funds. After considering these things for a moment, we might conclude that our public housing program has been remarkably successful with the funds it has had to work with and the social problems and prejudices it has had to face.

Ask yourself what are the alternatives. In the most robust period of private housing activity the lower income families have not been adequately served. And the private housing industry has had numerous other problems as well in low-income housing including excessive profits, shoddy work, tax-rip-offs, lack of interest or ability in management, inadequate unit sizes, and a failure to serve rural areas. The private housing industry has done a good job of serving those who can afford it, and should continue to do so. In fact, it might be a good idea to privatize all FHA mortgage insurance programs—they are perhaps a luxury we cannot afford in government right now. But private industry has not served the low income population well.

There are of course the nonprofit housing organizations many of us are associated with. These organizations have been beset with funding and administrative problems, and those that have tried hardest to serve the poorest persons have registered unimpressive production records thus far. While it is undoubtedly true that the problems of nonprofits merely reflect the failure of national housing policy and the inadequacies of existing programs, there remain a number of other questions we must consider.

For example, if public agencies are now unresponsive, there is at least the possibility of pressing them to fulfill their obligations under the law. What assures us that nonprofit housing organizations will be more responsive, and how can we deal with them if they are not? As private organizations, they are essentially free from political responsibility.

Actually, major reliance on nonprofits for low-income housing is almost regressive. It is based upon traditional ethical and religious notions of good works and good will, which we found many years ago to be inadequate in meeting our basic social needs. In many ways, nonprofits resemble alms or turkey baskets distributed on Christmas by charitable groups. We would not consider placing primary responsibility for social security or the highway and defense programs in the hands of the First Zion Church or any other locally created nonprofit organizations. Why should we consider this type of organization as the primary supplier of low-income housing?

There is also the problem I have mentioned a number of times before. Nonprofits are not created by public action, but merely encouraged. We have had enough encouragement, what we need is decisive action.

All of this is not to say that nonprofits have not played an important role thus far. They have been advocates and active supporters of better low-income housing programs. They have developed knowledgeable critics and the beginnings of a constituency for housing issues. In many areas, they have been the sole providers of low-income housing.

It also does not mean that they have no future role. The way things look now, nonprofits will be producing good housing for many years to come. Even if an effective public housing system was created soon, which is highly unlikely, nonprofits would have a number of complementary roles.

What I am saying here is that we must have a comprehensive and reliable low-income housing system to serve as *the primary* provider of housing. Whatever other approaches we take to low-income housing might be good and necessary, but should be seen as only supplementary to a basic public system.

Conclusion

In concluding, I would like to express the belief that most of us here do not really enjoy discussing methods of delivering subsidized housing. Nor do we enjoy being constantly reminded of the desperate need for subsidized housing.

We would all prefer, I'm sure, to discuss some way to provide jobs and living wages for all citizens, and an adequate level of support for those unable to work. But this is perhaps the most unrealistic program in light of current attitudes and economics. In place of it we must manipulate what we have available in order to create a rational and effective subsidized housing system.

Whether or not we can put together a low-income housing delivery system as I have described here remains to be seen. Any system which relies upon decisive governmental action and cooperation at all levels might be too much to expect. To be perfectly honest, nothing would please me more than to take the bull by the horns, so to speak, and place all the financial *and* development powers necessary to provide the needed housing in one federal agency. But this is clearly against the trend, and political realism dictates that state and local governments be provided a stronger role. Normally, I would say that we can *hope* that all levels of government will accept a greatly expanded responsibility for providing low-income housing. But we are not here now so that we can all *hope* together. We are here so that we can all *act* together. We must begin to act at the federal, state and local levels, in the legislatures and the executive branches. We must go to them with a clear agenda for action that we will vigorously pursue.

I therefore ask all of you to think hard about your role in this undertaking, and then go home tonight to get a good rest, because tomorrow morning at 9 o'clock all of us here will take our first united step towards making a low-income housing program that can really work. We will need all the energy we can muster.

Toward a National Federalism

SUMMARY OF THE REMARKS OF CLAY L. COCHRAN, SECOND NATIONAL RURAL HOUSING CONFERENCE, WASHINGTON, D.C., NOVEMBER 29, 1972

From time to time we must take our bearings, and see if we can agree on certain assumptions, certain ascertainable facts and their juxtaposition to each other. Then if we have some reasonable consensus, we can proceed with a pr gram which although not resting on immutable principles at least appears to be not in conflict with reality.

We are concerned with the people who live in rural areas and towns of 25,000 population and below.

Some facts and assumptions

1. People have a right to decent housing, including an adequate supply of drinkable water and waste disposal facilities.

2. If we are to provide decent housing for people most of the public costs must be borne by the Federal Government. The cost may be covered, in part, by a better welfare system, or a negative income tax, eliminating the many millions whose actual available income for housing is or should be zero.

3. Economy requires that the basic cost be borne as directly as possible out of Federal revenues or borrowing.

4. It is essential we recognize that the housing problem is the result of caste and class. For most of our people, the housing problem is a simple matter of having the income with which to buy decent housing from the private enterprise system, but for many millions decent housing is hard to come by for reasons of caste, i.e. skin pigmentation and culture. This is true of Chicanos, Blacks and to some extent the native Americans, the Indians, whose problems are further complicated by the fact that they are in part tied to so-called reservations and largely governed by a colonial organization known as the Bureau of Indian Affairs. To the extent that minority groups are happy to stay where they are, the problem is largely one of income, but if they seek to move into that so-called mainstream the housing problem is greatly aggravated by the American addiction to racial prejudice in all its crude and subtle ramifications. Suffice it to say that the housing problem is not solely one of the maldistribution of income, not directly.

5. Another basic assumption, is that if a housing program for small town and rural people is to be successful, it will have to be planned, financed and administered as a rural housing program. Housing programs designed to function in metropolitan areas will not work in rural areas, or will work poorly.

6. Metropollyana is a fact of life in this county. Metropollyana is a state of social hypnosis which leads people to believe that sooner or later everybody will move to one of ten big cities and live happily ever after.

Every act and agency dealing with housing or water or sanitation reveals the influence of metropollyana. Unfortunately most people do not even realize they suffer from this hypnosis and the sooner we can persuade them to affect a diagnosis the sooner we can deal with their problem.

Now with these basis assumptions, what do we have to do to provide decent housing for people in some towns and rural areas?

Financing out of taxes is the cheapest way

There is no cheap way to provide people with decent housing. It is going to cost a lot of money which one way or another, sooner or later, is going to have to come out of taxes.[1] The cheapest way to provide people with decent housing is directly, with funds raised out of taxes. Given if you will, but that is the easiest, cheapest way.

The next most inexpensive way to give subsidies to people is to finance them out of Federal borrowing. Federal, state or local government can finance decent housing on credit, but the Federal government can raise money cheaper by a considerable margin than any other level of government, provided you keep in mind that tax exempt local bonds rob the Treasury and increase the taxes of all but a small minority of the people.

Be that as it may, decent housing should be subsidized primarily out of Federal funds, taxed or borrowed, and should go to the needy as directly as possible. Middlemen cost money.

If housing subsidies are financed any other way, it is our responsibility to make clear to the White House and the Congress and the public that the higher cost of providing essential human shelter by other means is not necessary but is merely a concession to whatever form of social racketeering is involved, e.g. interest rate subsidies, tax ripoffs as in limited dividend corporations—you name it. But let us try to keep the game as inexpensive and honest as possible.

(This betrays no more than a normal bias against private lenders, who have a vital function to perform in our society, but they should perform it in their own private enterprise arena and when the community decides it must subsidize housing for people who are camping out under the bleachers the private lending groups have no God-given right to set up toll gates against the taxpayer or the poor. I cannot say that some of my best friends are mortgage bankers, but that is cruel fate; I wish they were.)

We should believe in the magic of ownership for the poor as well as the rich

We should put a premium on individual, private *ownership* of housing and the subsidy for ownership *should* exceed the subsidy for rental shelter, with due safeguards to protect the taxpayer against windfalls, bonanzas, giveaways and the eternal tendency of some people, rich and poor, to make a good thing out of every situation.

Home ownership is far more important to low-income people than it is to the affluent because it tends to be the only thing in their lives on which they have a grip. The affluent have other means of achieving a sense of security and self determination.

Who should build and manage rental housing for low-income people?

Ideally, rental housing for low-income people should be built, owned and operated by the lowest (most local) level of government possible, as it is in England, but our experience with local government here tends to be less than salubrious. In this country, state and local government have relatively unresponsive to housing needs, particularly in small towns and rural areas. Local governments have also tended too often to be racist.

The economics of the situation are such that decent housing is difficult for the most local of government to provide, particularly in small towns and rural areas. This is primarily the result of the inadequate level of Federal funding, but it is a simple fact that given the penurious funding by the Congress (and the recent tendency of the Executive branch to impound authorized funds) strictly local

[1] Obviously if the real output of our economy is growing rapidly the burden of taxes required can be minimized, but it can never be avoided.

governments have not and cannot acquire enough public housing units to permit adequate administration. Public housing programs which are too small are sometimes the result of sparse population or limited need, but whatever the reason it is apparent that public housing programs should be administered at a level which will permit the construction or acquision of enough units to permit proper management.

Balancing inadequate funding against economies of size is a task for the angels but the task is there and we should avoid the proliferation of two-bit housing authorities when larger units can be arranged.

The plain truth is that unless funding for public housing can be greatly expanded, that program will continue to be a disappointment in many places and unavailable in even more.

Toward national federalism

I believe in national Federalism, which means that as citizens of the United States we should insist that if a man can be taxed or drafted to fight in a war by the Federal government because he is a citizen, we have the obligation to see that he is in fact a citizen and that he is not deprived of food, medical care, police protection or shelter by any branch or level of the government. If you will consider this, you will find the implications are overwhelming.

National Federalism means that if local or state governments are provided with Federal subsidies for the purpose of providing decent shelter for all people that the states and local governments are not just ALLOWED to take care of this problem, they are REQUIRED to take care of it.

Enough of this permissiveness, I say. Let us have an end to the permissive way in which we have allowed state and local governments to degrade and neglect and harrass citizens of this nation.

Therefore, I believe that while we are overcoming the tendency of the White House and the Congress to give the military a blank check and provide peanuts for housing, and have told the state and local governments that a decent system of housing subsidies are available, we should simultaneously tell the states that they have the responsibility to either provide that housing or see that each and every local government does so, down to the lowest practical level dictated by the economics of population and need. And that we build into the law every punitive device we can contrive to see that this is done. For example: No urban renewal funds should be available to any city in any state which does not have a housing plan for the poor; no water and sewer subsidies should be available to any state without a decent housing plan; no highway funds should be allocated to any state which does not have an adequate plan for housing its people.

Like I said, enough of this permissiveness!

And, since we know enough about government to know that there as elsewhere the plans of good mice and men go astray, the Federal government should stand ready, with ample funds to build housing on its own or through permanent non-profit groups similar to the rural electric co-ops, owned by those they serve, when local government fails.

If we believe what we say we believe, and if we really believe in the responsibility of self determination, we must build into the laws the opportunity for maximum participation by the people involved—at the housing level.[2] Many if not most of the evils that afflict public housing, in my opinion, stem from income ceilings on the projects and the refusal of administrators to permit tenants the rights most of us take for granted.

But the approach of those who are trying to increase the ceilings on those to be admitted and the ceilings on those who can remain before achieving a dramatic increase in the amount of public housing available is just plain backward.

I would like to make it clear that in stressing public housing in such detail, I am not suggesting that we can or should try to solve the housing problem by that means alone, a point to which I will return.

Rural areas and small towns have the biggest problem and the least means for dealing with it

Since the housing problems in small towns and rural areas are out of proportion to their resources, how do we go about the task?

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[2] This should apply just as much to Federal subsidized private non-profit housing as it does to public housing, and if it does not just brace yourself.

First, of course, the public has to be convinced that there is a housing problem there, off the four-lane highways. Don't think that task has been completed.

Somehow we are going to have to find allies in other areas, in the central cities and even suburbia. Earlier this year when the first version of the House housing bill was reported, in all 270 pages there was not one meaningful reference to rural housing. There were some very significant rural housing provisions in that bill by the time it was killed. (Laughter!) Some even more significant provisions had been rejected, like the Norwegian plan and Federal guarantee of land titles, because they appeared to infringe on the sacred interests of private lending institutions and title insurance companies, not to mention that sacred unbalanced Federal budget which was already in the red about $40 billion for other purposes.

But if something really significant is to be done about indecent housing in small towns and rural areas, it will call for some alliances, and a lot of homework. We are going to have to know a great deal more about what the costs will be; ways to carry out the program with speed and economy without jeopardizing the freedom and rights of low income people. If you think someone else is going to do this for you, *caveat*. Either they won't do it, or you won't like the results.

Fat cat suburbanites who live off the fat of this land must be convinced that they have a personal reason for concern for the dying central cities and the devastated rural areas. We may have to administer a few lessons in political economy to these charming people.

They have, after all, flourished on a system of subsidies which have been adequate to the financing of what, in the words of a late Senator, enabled them "to roll on in the magnificence of an ottoman's seraglio". We have subsidized their homes with tax deductions; fancy highways and by-passes and clover leafs; farm subsidies and tax loopholes galore. We may have to work out a few tradeoffs with them. . . .

But we must also assume that if this problem is called to the attention of enough people that there is enough goodness and charity and rationality in the American people that they will divert a few hundred millions a year in our spiralling trillion dollar economy to meet the grim and degrading needs of their fellow creepers.

And, finally, we must not neglect Kenneth Boulding's glorious principle that "Where there is hypocrisy, there is always hope". Our leaders tell us that we are the greatest people they ever led; they insist that our economic system is the nearest thing to utopia the world has ever known; and they have written two laws now, one in 1949 and another in 1968, pledging this nation to the provision of a decent home and environment for every family, regardless of race, color, sex, character or location. Let's never miss an opportunity to "rub it in" for such portion of eternity as necessary, until they pant joyfully at the fulfillment of their pledge.

Prayer and exhortation are not enough; the rhetoric palls

While keeping in mind the above generalities, I'd like to urge you to study a specific piece of legislation introduced a little over a year ago in the Senate by Senator McGovern and others and in the House of Representatives by Congressman Abourezk and others. These bills would create a new and independent housing agency called the Emergency of Rural Housing Administration to administer to the specific housing and community facilities needs of the rural poor. The ERHA is given a life of five years and given the funding and authority to accomplish its tasks in that time period. It is instructed to serve the poorest first and race the other housing agencies for the moderate income families later. To assure its independence from existing agencies and to encourage some creativity, the ERHA would be staffed by non-civil-service employees. This would tend to inhibit bureaucrats (in the worse sense of the word) from other agencies from moving in and running this one since they would be forced to give up the security blanket they now enjoy. More importantly it would allow the agency to be staffed by a lower income and minority people who are qualified but cannot breach the Civil Service barriers.

We have pointed out that there exists a wasteland of housing credit in communities between 10,000 and 25,000 population and everywhere for the very poor.

This agency would remedy that by making eligible for its assistance any person who lives or desires to live in a rural area or community and who cannot secure minimum housing facilities by any other means within two years. Rural area is

defined as any "open country or any place outside a standard metropolitan statistical area," and small community is defined as a town of 25,000 people or less.

We spoke earlier of the need for deeper subsidies. This law would provide them:

> The agency could lend money to buy or rehabilitate houses, for ownership or rental. It could lend money at one percent for ownership and postpone payment on half the principal. No eligible person could be required to pay more than 20 percent of his adjusted income for principal, interest, taxes and insurance, but a family *may* pay more if it desires in order to be eligible for a loan. (Adjusted income is total income less 5 percent, less $300 for each member of the family and less $1,000 for any disabled or mentally retarded member.)
>
> The agency could buy land and develop it for housing. It could finance rental projects, water and sewer and other community facilities. In rental projects, no person will be required to pay more than 25 percent of his adjusted income for the total cost of rent, heat, water and electricity.

In other words, all low-income families in these rental projects would benefit from subsidies akin to those which should be supplied under the Brooks Amendments. Any family renting under ERHA program would be encouraged to purchase their unit when they can afford it.

The key to the success of the program, I think, lies in the manner it is envisioned to operate. It provides for a strong, adequately financed federal institution working directly with local agencies, either public or private, guided by the potential consumers. These local agencies would assume and enter into an "area responsibility agreement" which in effect says that they agree to serve all of the eligible persons in that area and does not allow for them to pick only those that they deem "deserving," or those that vote for a particular candidate, or agree to give up their welfare check. Personally, I would hope that units of local government would choose to be the local housing agency, and that they would choose to do so for the benefit of those which the law intends to serve. But I realize that reform of local government is not going to come about over night and especially because there is a new law to house the rural poor, so I agree with this law when it provides for other types of organizations, either presently formed or to be formed specifically to carry out the act. This is an important safety valve which is not found in other legislation. It provides the Federal government with a choice of who will spend the tax payers money and how. In addition, the law implies that if no local agency is capable to the task, federal employees can move in and do the job.

While providing for the creation and funding of these new local institutions the law permits the use of its funds to supplement existing housing programs. For example, it could supplement public housing or Farmers Home subsidies and personnel.

A dramatically important section provides that no eligible person shall be required to relocate to facilitate economic development, meaning that no person can be forced to move to please some planner who believes he should live somewhere other than where he wants to be, marking a pause if not an end to the propaganda for forcing people into so-called "growth centers."

To prevent the local agencies from experimenting with the lives of the poor by putting them in paper houses or trailer shacks, the law would require that houses be built to last 50 years with minimum maintenance costs, and that the plans and location for the housing shall be "developed with the active participation" of the people to be served. Housing of a more temporary nature could be constructed where there is a demonstrated need for such housing.

This law would also meet objections to current methods of financing housing where the subsidy goes to private money lenders and only secondarily to the consumer. Under this law, the administration of the program, the construction of the housing and community facilities and its operation would be paid for initially from funds from the U.S. Treasury.

The significance of this Emergency Rural Housing bill is not that it, as such, should be enacted, although that would certainly fulfill the pledge of the Congress, a pledge which is turning moldy around the edges. The most important thing about this bill is that it calls for some thought and a response from the Captains of the status quo.

It proposes a dramatic attack on a problem which should long since have ceased to exist, and says to the existing housing agencies, the chiefs of the vari-

ous levels of government, the lobbyists representing the coterie of vested interests who look upon the right to shelter as something behind their little old toll gate, "Come up with something as good, or better, or more practical . . . but come up with something more than tax ripoffs and shoddy real estate deals and trailer shacks".

I am not sure whether I am speaking here as an educator, an executive director of RHA, an educational organization, or as Chairman of the Board of the National Rural Housing Coalition, an organization which thinks the solution to the rural housing problem is political and not economic; but my view from under both of these hats is the same: Congress should hold extensive hearings on this ERHA bill and in that process help us discover what is the best, or, for heaven's sake, a better road than the one we are on.

STATEMENT BY LLOYD W. MORRIS, PRESIDENT OF FCH SERVICES, INC.

In light of the criticisms of Section 236 Housing, which has been made in the Hearings before your Committee, we felt that you should have for the record evidence of the successes of this program as we have experienced in cooperative housing.

FCH Services, Inc. is a subsidiary of The Foundation for Cooperative Housing, a private, nonprofit sponsor of Section 236 cooperatives and other cooperative housing projects. Serving as a technical consultant to those Foundation sponsored cooperatives, FCH Services, Inc. has brought into being 81 new housing cooperatives consisting of 167 mortgage parcels under Title 236 with a value of over $225 million.

These new cooperative projects have been brought to the stage of initial mortgage closing during the years 1970, 1971 and 1972. They include 12,400 townhouses or garden apartment units with a mortgage value on completion of $225 million. In addition, HUD has funded other FCH sponsored projects which have not yet gone to closing involving 6,300 units valued at $131 million.

These new cooperatives are in nineteen states and the Virgin Islands. A breakdown according to state is attached hereto as part of the record.

While multifamily home ownership is difficult to organize, process and market under current HUD regulations, the FCH record demonstrates that it is possible to produce large quantities of good housing under the current program.

Of the 167 new cooperatives or sections of cooperatives, ten have had difficulties either in keeping current on mortage payments or with other problems. Few have ever fallen behind in their mortgage payments, and none have gone to foreclosure. Of those few that are behind in their mortgage payments, it is because of greatly increased property taxes and utility costs. For these projects, we have been able to develop plans to resolve the difficulties and to bring the mortgages current. To provide adequate management for low income projects is one of the most difficult aspects of the housing program.

We have some specific recommendations we would be happly to make to facilitate and improve this program if you request such information. In the meantime here is some background you might find interesting.

The Foundation for Cooperative Housing was organized in 1950 and FCH Services, Inc. in 1952. They have sponsored and brought to completion 55,000 units of cooperative housing. In the early days these projects were largely unsubsidized middle income housing built under Section 213. We also completed a number of important conversions of public and private housing to cooperative ownership during those early years.

In 1961 we began to organize additional projects under Section 221(d)(3) below-market interest rate. This was the best of all the programs. We provided nearly 20,000 units of cooperative housing for families of limited income under that program. In 1964, 221(d)(3) was fixed with a low interest rate and two percent down payment. Unfortunately, it was necessary to switch to Section 236 when the Johnson Administration, and later the Nixon Administration, abandoned the 221(d)(3) program and moved to the interest subsidy program known as Section 236.

Our record cited above in Section 236 speaks for itself. We are happy to cooperate with you in any way you feel we could be of additional service. We summarize below our position on the subject of housing programs in general:

1. CONSUMER PROTECTIONS TO AVOID PAST ABUSES

Too little attention has been given to the protection of consumers in housing programs. Present laws do not give them enough protections. That is one of the reasons that defects have been found in some homes on which HUD insured mortgages, particularly existing houses.

At a time when we are consolidating and improving the housing laws, we must give first priority to providing consumer protections which will avoid past abuses and difficulties in the HUD programs. In part, these difficulties have been due to lax administration of our housing laws, but they are also partly due to inadequate consumer protections in existing laws. We need legislation which will require that all housing constructed with HUD mortage insurance assistance must be of good quality and that the prices and rents must be reasonable. Accordingly, FCH supports H.R. 16704, reported by the House Committee, which provides these consumer protections.

2. URGENT NEED TO CONTINUE AND TO EXPAND THE SECTIONS 235 AND 236 PROGRAMS

FCH has found that most of the complaints and criticisms about HUD programs did not involve new construction or rehabilitation of housing under Sections 235 or 236. From our study of the 235 and 236 programs, we have concluded that they have generally been effective in meeting their objectives and that their continuance is imperative to provide housing which is urgently needed by those of moderate incomes. FCH is pleased that its conclusions were verified on November 9, 1972, by a comprehensive study of the Real Estate Research Corporation.

3. HOUSING ALLOWANCE EXPERIMENTAL PROGRAM

Until the results of the present experimental program are available after its two-year period and until determinations have been made on the major questions described below, we recommend that there be no further expansion of the housing allowance program. Above all, we must assure that a housing allowance program will not have an adverse impact on stimulating new construction of housing to meet national goals and to assure the additional supply of housing needed for persons of low- and moderate-incomes.

HUD has recently activated a two-year experimental program under which families will receive housing allowances. We urge that this experimental program involve explorations to determine whether it is feasible:

(a) To provide necessary consumer protections to assure that Federal housing allowances will not inflate housing charges by limiting the use of existing standard structures to cases where there are sufficient vacancies in the community to avoid increases in housing charges.

(b) To assure that housing allowances will be used solely to pay for housing costs rather than being diverted for other purposes.

(c) To assure that Federal housing allowances will result in adding to the inadequate supply of standard housing in the community through new construction or rehabilitation, except to the extent that standard vacant housing at reasonable charges is available in a suitable neighborhood.

(d) To provide standard housing for low income families at a cost per family which does not exceed the cost of providing such housing under existing programs and which does not involve a larger national expenditure than the annual budgetary cost projected under existing programs.

4. SUPPORT FOR AN OMNIBUS HOUSING AND URBAN DEVELOPMENT ACT—1973

We strongly supported the Housing and Urban Development Bill passed by the Senate (S. 3248) in the last session of Congress in 1972. A similar Bill was reported out by the House Banking and Currency Committee, but the Rules Committee did not clear floor action on that Bill. Consequently, the last Congress did not enact a Housing Bill. We recommend that the new Congress enact legislation as soon as possible similar to S. 3248, with the addition of many provisions in the House Bill as recommended in our report.

5. We strongly support this consolidation and simplification program. It will establish uniform policies which will replace present differences between programs which have separate income limits, construction and design standards,

income definitions, and ratios between income and required housing payments. It provides a uniform and flexible housing formula to serve families who cannot afford the cost of housing on the private market. It will help to promote a policy of economic integration in assisted housing to discourage the segregation of low income families in housing projects.

6. We concur in the recommendation of the Administration that the income limit for assisted housing should be the median income in the area, with authority in the Secretary to exceed the median by the amount required in order to meet the housing needs of the locality based on its income and cost factors. We recommend that the provision in the Senate and House Bills provide for an income limit equal to the median income in the area.

7. LOCAL GOVERNMENT APPROVAL

We vigorously oppose the provision in the home ownership assistance program (402), multifamily housing assistance program (502), sections 235 and 236 and units of low income housing in private accommodations, which provides for local approval of all of these projects—containing 8 or more dwelling units—by the local governing body unless the local governing body waives its right to do so, or delegates its right to a local agency which then must approve the project. There is no need to single out assisted private housing for such approval.

8. Under the HUD program, such assisted private housing will not pose an architectural or structural threat to a community or involve any tax exemption. We are concerned that if the assisted private housing programs are singled out for such treatment that a local and vocal minority may be able to significantly decrease the ability to construct such assisted private housing which is urgently needed. This provision in the House Bill will invite community discrimination against assisted private housing and establish a serious constraint on the availability of building sites for such low and moderate income housing.

FCH-SPONSORED 236 COOPERATIVES

[Totals by State]

State	Number co-ops	Number units	Mortgage total
1. Colorado	1	40	$580,600
2. Florida	2	515	8,041,500
3. Georgia	9	1,992	31,768,800
4. Illinois	2	305	6,960,700
5. Indiana	19	2,745	47,807,100
6. Kansas	5	361	6,092,300
7. Maryland	4	586	12,772,600
8. Massachusetts	1	88	1,835,600
9. Michigan	16	2,538	52,055,800
10. Minnesota	1	90	1,900,400
11. Missouri	3	308	6,583,500
12. Nevada	1	108	1,774,700
13. New Jersey	1	88	1,897,900
14. New York	1	260	6,508,400
15. North Carolina	1	180	3,006,300
16. Ohio	6	1,053	20,584,300
17. Oklahoma	1	60	935,400
18. Virginia	5	492	8,476,700
19. Washington	1	94	1,947,100
20. Virgin Islands	1	189	4,297,300
Total	81	12,092	225,827,000

STATEMENT BY NATHANIEL S. KEITH, PRESIDENT OF THE NATIONAL HOUSING CONFERENCE, INC.

I welcome the opportunity to present the views of the National Housing Conference on the important subject of housing and community development.

We are the oldest public interest organization in the housing and urban field. As you may know, our Legislative Policy Committee met last week and called for a renewed start in the new Congress and Administration on major legislation both to strengthen the housing and urban programs and to correct deficiencies in them.

In summary, our proposals include: release of adequate operating subsidies to maintain the solvency of public housing; a strong consumer protection section, such as that written into the House Bill earlier this year, to prevent abuses; support for a comprehensive housing and community development bill, such as that passed by the Senate in 1972; and an improved uniform relocation act such as the one that failed to reach final action this year.

We strongly opposed provisions in this year's House Bill that would have required local government approval of any subsidized home ownership or rental project built by the private sector for low and moderate income people.

Other items in our Report include a defense of the Section 235 and 236 home ownership and rental subsidy programs as having been generally effective and involved only to a limited extent in complaints of abuses in the housing programs, which the proposed consumer protection provisions would prevent.

We strongly favored housing subsidies based on the median income level in a locality rather than on limited dollar incomes as in the past. We also favored continued but only limited experiment with housing allowances, as a possible substitute for housing subsidies, until it can be determined if sufficient protections can be built into such a program for the housing needs of the people.

The following is a more detailed summary of our position:

1. MEETING DEFICITS IN PUBLIC HOUSING PROJECTS

It is imperative that funds be released which are currently authorized in the approximate amount of $325 million for operating subsidies to meet deficits in public housing projects, including: (a) adjustments for inflation; (b) reimbursement for losses on welfare families and others whose rentals were reduced by the limitations in the Brooke Amendment; (c) establishment of adequate operating reserves; and (d) payments in lieu of local taxes of 10% of shelter rents including the operating subsidies which offset reductions in such rents required by the Brooke Amendment. The Federal Government is committed to make these payments under contracts made by it pursuant to Federal laws. Likewise, it is imperative that additional amounts be authorized and made available in the full amounts required to meet future operating deficits in public housing projects. These actions are necessary to avoid the bankruptcy of local housing authorities and to restore their financial stability.

2. CONSUMER PROTECTIONS TO AVOID PAST ABUSES

Too little attention has been given to the protection of consumers in housing programs. Present laws do not give them enough protections. That is one of the reasons that defects have been found in some homes on which HUD insured mortgages, particularly existing houses.

At a time when we are consolidating and improving the housing laws, we must give first priority to providing consumer protections which will avoid past abuses and difficulties in the HUD programs. In part, these difficulties have been due to lax administration of our housing laws, but they are also partly due to inadequate consumer protections in existing laws. We need legislation which will require that all housing constructed with HUD mortgage insurance assistance must be of good quality and that the prices and rents must be reasonable. Accordingly, NHC supports H.R. 16704, reported by the House Committee, which provides these consumer protections.

3. URGENT NEED TO CONTINUE AND TO EXPAND THE SECTIONS 235 AND 236 PROGRAMS

NHC has found that most of the complaints and criticisms about HUD programs did not involve new construction or rehabilitation of housing under Section 235 or 236. From its study of the 235 and 236 programs, NHC has concluded that they have generally been effective in meeting their objectives and that their continuance is imperative to provide housing which is urgently needed by those of moderate incomes. NHC is pleased that its conclusions were verified on November 9, 1972, by a comprehensive study of the Real Estate Research Corporation.

4. HOUSING ALLOWANCE EXPERIMENTAL PROGRAM

Until the results of the present experimental program are available after its two-year period and until determinations have been made on the major questions described below, NHC recommends that there be no further expansion

of the housing allowance program. Above all, we must assure that a housing allowance program will not have an adverse impact on stimulating new construction of housing to meet national goals and to assure the additional supply of housing needed for persons of low- and moderate-incomes.

HUD has recently activated a two-year experimental program under which families will receive housing allowances. We urge that this experimental program involve explorations to determine whether it is feasible:

(*a*) To provide necessary consumer protections to assure that Federal housing allowances will not inflate housing charges by limiting the use of existing standard structures to cases where there are sufficient vacancies in the community to avoid increases in housing charges.

(*b*) To assure that housing allowances will be used solely to pay for housing costs rather than being diverted for other purposes.

(*c*) To assure that Federal housing allowances will result in adding to the inadequate supply of standard housing in the community through new construction or rehabilitation, except to the extent that standard vacant housing at reasonable charges is available in a suitable neighborhood.

(*d*) To provide standard housing for low income families at a cost per family which does not exceed the cost of providing such housing under existing programs and which does not involve a larger national expenditure than the annual budgetary cost projected under existing programs.

5. FULL FUNDING AND USE OF ALL AUTHORIZATIONS

NHC calls for full funding and use of all authorizations. We call upon the Administration to release immediately the following and other funds already made available by Congress but continued to be impounded:

(*a*) Release of $325 million for operating subsidies authorized by the Brooke Amendment to provide the funds necessary to meet deficits resulting from the Amendment's limitation that rents are not to exceed 25% of family income, together with additional funds for new public housing.

(*b*) Release of the entire monies available for the Sections 235, 236 and Rent Supplement Programs. This includes:

(i) Section 235—$83,400,000 carry over from Fiscal Year 1972 for a total of $253,400,000 available in Fiscal Year 1973.

(ii) Section 236—$88,100,000 carry over from Fiscal Year 1972 for a total of $263,100,000 available in Fiscal Year 1973.

(iii) Rent Supplement—$26,900,000 carry over from Fiscal Year 1972 for a total of $74,900,000 available in Fiscal Year 1973.

(*c*) Release of the balance of $370,000,000 of the $500,000,000 appropriated for Water and Sewer Facilities Grants. Only $130,000,000 has been released to date.

(*d*) Release of balance of $70 million of the $120,000,000 made available for the Rehabilitation Loan Fund. Only $50,000,000 has been targeted for release to date.

(*e*) Release of $5 million of Special Planning Grants for the New Communities Program.

6. SUPPORT FOR AN OMNIBUS HOUSING AND URBAN DEVELOPMENT ACT—1973

NHC strongly supported the Housing and Urban Development Bill passed by the Senate (S. 3248) in the last session of Congress in 1972. A similar Bill was reported out by the House Banking and Currency Committee but the Rules Committee did not clear floor action on that Bill. Consequently, the last Congress did not enact a Housing Bill. NHC recommends that the new Congress enact legislation as soon as possible similar to S. 3248, with the addition of many provisions in the House Bill as recommended in our report.

7. NHC strongly supports this consolidation and simplification program. It will establish uniform policies which will replace present differences between programs which have separate income limits, construction and design standards, income definitions, and ratios between income and required housing payments. It provides a uniform and flexible housing formula to serve families who cannot afford the cost of housing on the private market. It will help to promote a policy of economic integration in assisted housing to discourage the segregation of low income families in housing projects.

8. In these resolutions, we concur in the recommendation of the Administration that the income limit for assisted housing should be the median income in the area, with authority in the Secretary to exceed the median by the amount required in order to meet the housing needs of the locality based on its income and cost factors. We recommend that the provision in the Senate and House Bills provide for an income limit equal to the median income in the area.

9. LOCAL GOVERNMENT APPROVAL

NHC vigorously opposes the provision in the home ownership assistance program (402), multifamily housing assistance program (502), sections 235 and 236 and units of low income housing in private accommodations, which provides for local approval of all of these projects—containing 8 or more dwelling units—by the local governing body unless the local governing body waives its right to do so, or delegates its right to a local agency which then must approve the project. There is no need to single out assisted private housing for such approval.

10. Under the HUD program, such assisted private housing will not pose an architectural or structural threat to a community or involve any tax exemption. NHC is concerned that if the assisted private housing programs are singled out for such treatment that a local and vocal minority may be able to significantly decrease the ability to construct such assisted private housing which is urgently needed. This provision in the House Bill will invite community discrimination against assisted private housing and establish a serious constraint on the availability of building sites for such low and moderate income housing.

11. UNIFORM RELOCATION LAW

New and expanded bills for uniform relocation passed both the House and Senate, but action on a final bill was not completed before the adjournment. NHC urges that this program be enacted as quickly as possible in the new Congress, and that the unrealistic and burdensome requirement that local public agencies assume one-third of the cost of the expanded relocation requirements be rescinded and the Federal responsibility to pay 100% of relocation benefits be continued.

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